Chapter 5

Actual Situations and Tasks Relating to Accounting of SMEs in non-ASEAN nations

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Chapter 5

Actual Situations and Tasks relating to Accounting of SMEs in Non-ASEAN Nations

1. Japan

(1) Current state of accounting of SMEs

1) Overall image of accounting systems

With the international wave of IFRS adoption, Japan has also been holding various discussions and debates on accounting standards since 2000. The discussions gained momentum in 2002 when the Small and Medium Enterprise Agency (SMEA) released the Report of the Study Group on SME Accounting in 2002. In 2005, they released the Accounting Guidelines for Small- and Medium-Sized Entities, and then in 2012, they released the General Accounting Standards for SMEs. These two accounting standards coexist.

The accounting standards applied to listed companies and non-listed companies subject to disclosure, in accordance with the Financial Instruments and Exchange Act (FIEA), are outlined below.

We briefly summarise the correlation between IFRS and accounting standards related to listed companies, non-listed companies disclosing under the FIEA, and large companies subject to the Companies Act, and then we discuss the two types of SME accounting.

2) Current state of accounting systems related to listed companies and large companies

In Japan, the application of the following four accounting standards is recognised for listed companies and large companies as of December 2015: IFRS, J-GAAP (Corporate Accounting Standards), the US Generally Accepted Accounting Practices (US-GAAP), and Japan's Modified International Standards (J-MIS). Since March 2010, the voluntary application of IFRS has been approved for the creation of consolidated financial statements. On the other hand, the consolidated financial statements and non-consolidated financial statements for the majority of listed companies and large companies are created based on the J-GAAP, which is released by the Financial Accounting Standards Foundation (FASF).

What can be noted as a unique feature of accounting standards in Japan is the existence of these four systems of GAPs: IFRS, J-GAAP, US-GAAP, and J-MIS[8].

Figure 2: 'Division of Accounting Systems' and 'Segmenting of Accounting Standards'

Category	Approximate number of companies	Financial statements		Audit by certified public accountant (or audit firm)
		Consolidated	Non-consolidated	
A) Listed companies	3,600	Voluntary application of International Financial Reporting Standards (IFRS)	Generally accepted accounting principles in Japan (J-GAAP)	Audit required
B) Companies disclosing under FIEA other than the ones in category A	600	Generally accepted accounting principles in Japan (J-GAAP)		
C) Large companies under the Companies Act with stated capital ≥ ¥500 million or total liabilities ≥ ¥20 billion – excluding category A or B companies	8,000	Not required to prepare		
D) All others – Corporations that are not in category A, B, or C	2.6 million		ASBJ Guidelines (2005) General Accounting Standard for SMEs	Audit not required

SMEs = small- and medium-sized entities; ASBJ = Accounting Standards Board of Japan; IFRS = International Financial Reporting Standards; J-GAAP = Japanese Generally Accepted Accounting Principles; FIEA = Financial Instruments and Exchange Act
Source: Teruyuki Kawasaki, Division of Accounting Systems and Segmenting of Accounting Standards, Accounting, Vol. 186, No. 5, November 2014.

3) Current state of accounting systems for SMEs

As indicated above, there are two accounting standards for SMEs in Japan: the Accounting Guidelines for SMEs and the General Accounting Standards for SMEs. Below are the characteristics of each accounting standard.

(i) Accounting Guidelines for SMEs

[8] Teruyuki Kawasaki, Accounting for Small- and Medium-Sized Entities, *Accounting*, Vol. 182, No. 5, November 2012.

(a) Position of the Accounting Guidelines for SMEs

The Accounting Guidelines for SMEs (Guidelines) were the first accounting standards for SMEs in Japan. The Guidelines are recognised as generally accepted accounting principles under the Article 431 of the Companies Act and have the following two objectives:

- To indicate preferable accounting treatments and notations during the creation of financial statements by SMEs.
- To indicate appropriate accounting practices for accounting advisors creating accounting statements in collaboration with company directors.

As suggested in the syntax, the Guidelines outline accounting practices considered 'preferable' or 'appropriate' for SMEs and it is important to note that they are not legally binding[9].

(b) Overview of Guidelines

The structure of the Guidelines is outlined in Table 24.

As is evident from Table 24, the Guidelines are comprised of four general provisions and 20 specific provisions. The details of each provision are based on the J-GAAP and the FASF reports. Stated plainly, the Guidelines are a simplified version of the accounting standards for large companies (public companies).

As grounds for this statement, the Guidelines are revised annually to reflect the content of revisions made to the J-GAAP.

[9] Teruyuki Kawasaki, Accounting System for Small- and Medium-Sized Entities, Cyu-ou Keizaisya, 2015.

Table 24: Structure of the Accounting Guidelines for SMEs (2014 Version)

Section		Description	Section		Description
General Provisions		Objective	Specific Provisions	9	Provisions and allowances
		Scope		10	Retirement benefit obligations/provision for retirement benefits
		Policy upon preparation		11	Tax expenses/tax liabilities
		Scope of entries and considerations upon application		12	Deferred Taxes
Specific Provisions	1	Financial receivables		13	Net assets
	2	Loss from bad debt/ allowance for doubtful accounts		14	Recognition of revenues/ expenses
	3	Securities		15	Lease transactions
	4	Inventories		16	Foreign currency transactions, etc.
	5	Accruals and deferrals, etc.		17	Accounting of reorganization (Accounting for business combinations and business divestitures)
	6	Fixed assets		18	Notes to non-consolidated financial statements
	7	Deferred assets		19	Mandatory publication of financial results and examples of balance sheet, income statement and statements of changes in net assets
	8	Financial payables		20	Matters to be studied in the future (Asset retirement obligations)

SMEs = small- and medium-sized entities.

Source: Teruyuki Kawasaki, Accounting System for Small- and Medium-Sized Entities, Cyu-ou Keizaisya, 2015.

(c) Status of permeation for the Guidelines

The goal for establishing these Guidelines was to specify accounting standards that would be easy for SMEs to implement. In reality, many SMEs are not creating accounting statements in compliance with the Guidelines. According to the Survey Related to SME Accounting [10] conducted by SMEA in March 2010, while 42.0 percent of companies targeted by the survey had somewhat an understanding of the content of the Guidelines, nearly the same amount or approximately 41.5 percent of companies were unaware of the Guidelines. This indicated that the content of the Guidelines was not sufficiently known. Regarding the level of compliance with the Guidelines, 45.1 percent of companies responded to being ‘in compliance’ (including partial compliance) but it became clear that only 15.9 percent of those companies were in ‘full compliance’.

The survey also confirmed what companies desired in the Guidelines. Around 21.7 percent of companies responded that they want ‘accounting standards that are consistent with tax practices’ and 14.7 percent of companies indicated that ‘tax accounting was sufficient,’ which is a combined 36.4 percent of companies. The group of companies preferring ‘accounting that follows tax practices’ represented the largest group. The next largest group (34.4 percent of respondents) stated ‘make accounting practices as simple as possible’. This indicates that SMEs desire a focus on tax accounting that simplifies accounting practices. On the other hand, only 4.4 percent of companies indicated a desire for ‘a focus on accounting practices that closely resemble listed companies’, indicating the lack of weight in this area.

(ii) General Accounting Standards for SMEs

(a) Position of the General Accounting Standards for SMEs (Standards)

In 2010, due to the lack of permeation of the Guidelines among SMEs, SMEA convened the Study Group on SME Accounting and organised an interim report. This interim report outlined four basic policies and five considerations related to the formulation of new accounting rules. The following table outlines those policies and considerations.

[10] http://www.chusho.meti.go.jp/zaimu/kaikei/2011/download/0823kaikei_enquete-1.pdf

Table 25: Four basic policies and five considerations related to SME accounting

Basic Policy	Consideration
1) *Organize accounting practices of SMEs:* Accounting treatment applied as a practice in actual accounting work of SMEs that may be regarded as financial accounting practices generally accepted as fair and appropriate under the Companies Act must be organized. (Specifically, this mainly involves accounting treatment based on the Corporation Tax Act and the Business Accounting Principles.)	a) Lawfulness under the Companies Act: If the accounting treatment is properly compliant with new accounting rules, its lawfulness under the Companies Act must be clear. b) Smooth transition to higher-level accounting standards: Consideration should be given to smooth transition to financial accounting standards and ASBJ Guidelines.
2) *Flexible Accounting standards in line with actual practice:* The new accounting rules must be flexible so that accounting treatment can be chosen from several options in line with the actual practice of the entity. (Application of the business accounting standards and ASBJ Guidelines is permitted as a matter of course.)	c) Consideration to accounting structure/accounting practices/ Corporation Tax Act: Accounting structure of SMEs, accounting practices in actual operations and harmony with treatment prescribed by the Corporation Tax Act should be given consideration, and recognized as appropriate accounting treatment.
3) *Simple and plain language that facilitates understanding by company decision makers:* Content must be written in simple and plain language with minimal use of technical terms and difficult expressions so that the top management of SMEs can understand it.	d) Frequency of revision: Revision work should be performed as little as possible to ensure stability. e) Relationship with financial accounting standards: Compilation and revision work should be performed separately from financial accounting standards.
4) *Importance placed on book entries:* Book entry must be incorporated as a key component.	

SMEs = small- and medium-sized entities.
Source: Teruyuki Kawasaki, Accounting System for Small- and Medium-Sized Entities, Cyu-ou Keizaisya, 2015.

The Standards represent the concrete embodiment of the above basic policies and considerations.

(b) Overview of General Accounting Standards for SMEs

The following table outlines the structure of the General Accounting Standards for SMEs.

The Standards are comprised of 9 general provisions and 14 specific provisions. In particular, the Standards focus on SME accounting practices (acquisition cost-based accounting, corporate accounting principles, and corporate tax law).

Table 26: General Accounting Standards for SMEs

Topic	Description	Features
1. General accounting treatment of revenues and expenses	a. Revenue: In principle, on a realization basis b. Expenses: In principle, on an accrual basis c. Application of matching principle d. Application of gross amount principle	i. Importance placed on revenue and expense approach
2. General accounting treatment of assets and liabilities	a. Assets: In principle, at acquisition cost b. Liabilities: In principle, at the amount of obligation	
3. Financial receivables and financial payables	a. Financial Receivables: In principle, at acquisition cost b. Financial obligations: In principle, at amount of obligation c. Notes on amount of discount on notes receivable and amount of transfer by endorsement	
4. Bad debt expenses and allowance for doubtful accounts	a. Legally extinguished receivables: Recorded as bad debt expenses b. Uncollectible receivables: Recorded as bad debt expenses c. Receivable at risk of becoming uncollectible: Recorded as allowance for doubtful accounts	i. Statutory deductible rate is presented as an example of the rate of provision of allowance for doubtful accounts
5. Securities	a. In principle, at acquisition cost b. Trading securities: Marked to market c. Valuation method: Periodic-average method, moving-average method, etc. d. If market value substantially falls: Booking of impairment loss, unless recovery is deemed likely	i. Trading securities assume trading securities under the Corporation Tax Act ii. Likelihood of recovery is determined by management.

Topic	Description	Features
6. Inventories	a. In principle, at acquisition cost b. Valuation standard: Cost method or lower-of-cost-or-market method c. Valuation method: Specific identification method, first-in, first-out method, periodic-average method, moving-average method, last cost method, retail method, etc. d. If market value substantially falls: Unless recovery is deemed likely, booking of impairment loss	i. Last cost method is presented as an example of equal rank as other methods ii. Likelihood of recovery is determined by management
7. Accruals and Deferrals	a. Prepaid expenses/unearned revenue: Excluded from profit/loss calculation b. Accrued expenses/accrued revenue: Reflected in profit/loss calculation	
8. Fixed assets	a. Classified into property, plant, and equipment, intangible assets, and investments and other assets b. In principle, at acquisition cost c. Property, plant and equipment: Reasonable depreciation performed according to declining-balance method, straight-line method, etc. d. Intangible assets: In principle, reasonable amortization according to straight-line method e. Useful life: Period prescribed in the Corporation Tax Act, etc. f. When asset value is found to have fallen substantially due to disaster, etc.: Booking of impairment loss	i. Reasonable depreciation may generally be deemed as depreciation performed systematically in each period throughout the useful life
9. Deferred assets	a. Deferred organization expenses, business commencement expenses, development expenses, stock issuance cost, bond issuance cost, share subscription right issuance cost: Treated as expenses or deferred assets b. Amortized over effective life	
10. Lease transactions	a. Accounting treatment by lessee according to method pertaining to operating lease transaction or sales transaction	i. Treatment as operating lease transactions is accepted

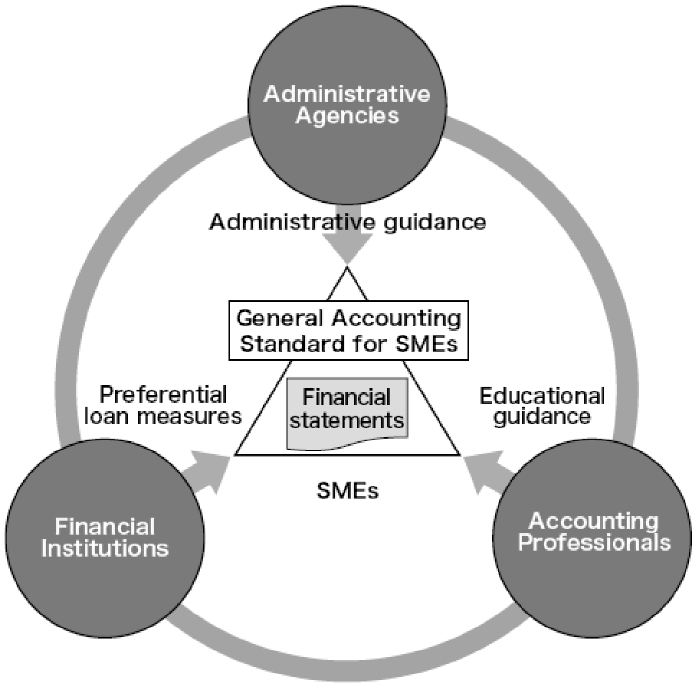
Topic	Description	Features
11. Provisions and allowances	a. Those meeting requirement of allowance: Presented in assets or liabilities section of balance sheet b. Provision for bonuses: Portion of the estimated amount of bonuses chargeable to the current period is recorded c. Provision for retirement benefits: Calculated based on the amount payable on retirement for personal reasons at the end of the period if a lump-sum retirement payment scheme is adopted d. If a scheme that does not generate additional burden after payment (Smaller Enterprise Retirement Allowance Mutual Aid System, etc.) is adopted: The installment in each period is treated as an expense.	i. For the provision for bonuses and provision for retirement benefits, the calculation method adopted under the Corporation Tax Act is presented as an example
12. Foreign currency transactions, etc.	a. Foreign currency transactions: In principle, at the yen-equivalent amount based on the exchange rate when the transaction occurred. b. Monetary claims and liabilities denominated in foreign currency: Yen-equivalent amount based on exchange rate at the time of acquisition or at the time of settlement of accounts.	i. Use of exchange rates prevailing when monetary claims and obligations are incurred is permitted
13. Net assets	a. Net assets: Amount equal to total amount of assets minus total amount of liabilities b. Shareholders' equity: Consists of capital stock, capital surplus, and retained earnings.	
14. Notes	a. Matters concerning significant accounting policies, matters concerning statements of changes in net assets b. If financial statements are prepared based on the General Standard: Write a statement to that effect in the notes.	i. Notes indicating that General Standard are observed have the effect of improving reliability

SMEs = small- and medium-sized entities.
Source: Teruyuki Kawasaki, Accounting System for Small- and Medium-Sized Entities, Cyu-ou Keizaisya, 2015.

(c) Initiatives towards dissemination of Standards

As discussed above, the Guidelines were the first accounting standards in Japan drafted and released for SMEs but the dissemination of these Guidelines was not sufficient. As a result, various initiatives were implemented to promote the dissemination of the Standards, which were drafted based on lessons learned from the Guidelines. While there is a limit to the dissemination efforts that can be implemented by any single organisation, tackling dissemination from a unified approach to systems, education, and implementation can result in efficient and effective dissemination.

Figure 3: Initiatives towards dissemination of Standards



SMEs = small- and medium-sized entities.
Source: Teruyuki Kawasaki, Accounting for Small- and Medium-Sized Entities, *Accounting*, Vol. 182, No. 5, November 2012 Edition.

Specific initiatives implemented by administrative agencies, financial institutions, and accounting organisations include the following types of initiatives.

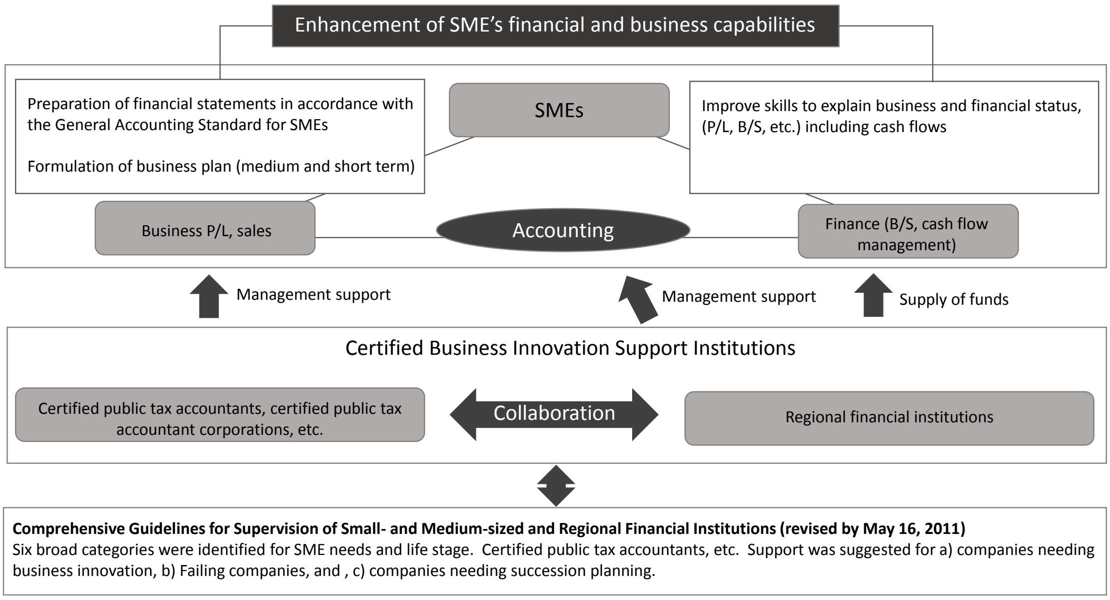
Table 27: Roles and initiatives by entity in relation to disseminating Standards

Entity	Major initiative
Administrative agency	Using administrative guidelines to promote dissemination of Standards. Specifically for Japan, this is the SMEA and the Financial Services Agency. ✓ Works with relevant government agencies and promotes dissemination of Standards by issuing administrative guidance. ✓ For example, expected measures include each local municipality making compliance with the Standards a condition for accounting statements submitted for SME financing applications. ✓ Also, an administrative agency-led initiative to create a collection of successful case studies related to the use of the Standards would be an effective method of promoting dissemination.
Financial institutions	Support through financing incentives and other substantive measures. ✓ For example, measures requiring that the creation of accounting statements are compliant with parameters is actually promoting the dissemination of the Standards. ✓ The Evaluation Workgroup Report on SME Accounting indicated the use of financial incentives by government financial institutions to support the dissemination of the Standards. This indicates that making government financial institutions take the lead in financing is another possible method.
Accounting organisations	Support dissemination of Standards through education and guidance. Accounting organisations refer mainly to tax attorneys and CPAs. ✓ The Standards must be used as a platform for educating and instructing SME owners on the concept that accounting organisations minimise accounting or intentionally remove records for the purpose of saving on taxes. ✓ Also serves the role of promoting awareness that bookkeeping and accounting are effective means of strengthening their business and promoting a deeper understanding among SME owners that this is vital to the survival of an SME.

CPA = Certified Public Accountants; SMEs = small- and medium-sized entities; SMEA = Small- and Medium-Sized Enterprise Agency.
Source: Teruyuki Kawasaki, Accounting for Small- and Medium-Sized Entities, *Accounting*, Vol. 182, No. 5, November 2012 Edition.

As a specific example of initiatives in this area, we discuss below the Small- and Medium-Sized Enterprise Management Enhancement Support Act, which was enacted in June 2012. This law was enacted with the goal of supporting the enhancement of financial management skills among SMEs. The core themes of this law are shown in the table below.

Figure 4: Structure of the Small- and Medium-Sized Enterprise Management Enhancement Support Act



P/L = Profit and Loss; B/S = Balance Sheet; SMEs = small- and medium-sized entities.
Source: Teruyuki Kawasaki, Accounting for Small-And Medium-Sized Entities, *Accounting*, Vol. 182, No. 5, November 2012 Edition. Extracts from the Interim Overview materials by the SME Business Policy Committee and Business Capability Workgroup.

As shown in Figure 4, the key points pertaining to Japanese SME Standards are as follows:

- Enhancing the financial management capabilities of SMEs is positioned at the core of achieving smooth management support and financing for SMEs.
- Enhancing the financial management capabilities of SMEs will require the organisation and application of new accounting rules and efforts on the part of SME owners to increase their accountability for business conditions and financial management.
- The new accounting rules required in line with the state of SMEs such as bookkeeping abilities are the Standards related to SME accounting.
- The objective is for SME owners to receive support from accounting organisations (tax

attorneys) and use the Standards to establish their own system of annual management (creation of management plans, capital plans, et cetera) to increase their accountability to financial institutions.

As we can see, it is characteristic of Japan to collaborate between administrative agencies, financial institutions, and accounting organisations to support the dissemination of the parameters as well as the actual laws established to aggressively promote the dissemination of the Standards.

(iii) Differences between and backgrounds of Guidelines and Standards

A comparison of the major differences between Japan's Guidelines and Standards are shown in Table 28.

Table 28: Major differences between Guidelines and Standards

Items	General Standard	ASBJ Guidelines
General Provisions		
(1) Entities that can use it	• SMEs that do not plan to go public and have simple accounting needs.	• All SMEs, but in particular those that have accounting advisors as defined by the Companies Act.
(2) Relationship with IFRS	• Independent of IFRS to assure stable and consistent use. • Will be revised only when judged necessary.	• Will be revised in consideration of revisions of the Business Accounting Standards in line with IFRS convergence. • Will be revised annually.

Items	General Standard	ASBJ Guidelines
(3) Book entry (the principle of orderly bookkeeping)	• Explicitly requires book entries to establish and maintain accounting records. • The principle of bookkeeping is positioned at a higher level than the principle of true and fair view.	• (No provision)
(4) The number of specific provisions and contents	• 14 basic topics (Topics such as accounting for deferred tax and accounting for business combinations and divestitures are excluded.) • Describes in simple and plain language matters that are necessary for SMEs to which the General Standard is expected to be applicable.	• 18 topics (Topics such as accounting for deferred tax and accounting for business combinations, and divestitures are included.) • Describes matters in more detail than the General Standard.
(5) Handling of accounting treatment for tax purposes	• Highly harmonized with accounting treatment for tax purposes so that it is consistent with accounting practices implemented by SMEs.	Tax accounting is applicable if and only if: • There are no applicable accounting standards and tax accounting can appropriately reflect the substance of transactions. • A treatment under tax accounting is not materially different from a treatment under financial accounting.
Specific Provisions		
(1) Securities	• Securities shall, in principle, be measured at cost. • Securities held for trading as defined for tax purposes shall be measured at fair value. • Securities available for sale shall be measured at cost.	• Marketable securities may be measured at cost under certain conditions—that is, in cases where the fair value of those securities is small. • Securities available for sale shall be measured at fair value.

Items	General Standard	ASBJ Guidelines
(2) Inventories	• The latest cost method may be used.	• The latest cost method may be used under certain conditions—that is, if there is no substantial detriment to the calculation of profit/loss for the period.
(3) Depreciation of fixed assets	• Fixed assets shall be depreciated in a reasonable manner.	• Fixed assets shall be depreciated in a systematic manner.
(4) Lease transactions	• Lease transactions shall be accounted for as rental transactions or finance/purchase transactions.	• Lease transactions shall be accounted for as finance/purchase transactions.
(5) Foreign currency transactions among others	• Foreign currency-denominated financial receivables and liabilities shall be recorded in their yen-equivalent value at the exchange rate on the transaction date or settlement date.	• Foreign currency-denominated financial receivables and liabilities shall be recorded in their yen-equivalent value at the exchange rate on the settlement date.

ASBJ = Accounting Standards Board of Japan; IFRS= International Financial Reporting Standards; SMEs = small- and medium-sized entities.
Source: Teruyuki Kawasaki, Accounting System for Small-and Medium-Sized Entities, Cyu-ou Keizaisya, 2015.

The following six items represent particularly significant differences.

(a) Use of bottom-up approach

As has been noted thus far, the Guidelines employ a top-down approach where the J-GAAP for listed companies and large companies are summarised and simplified for SMEs. Conversely, the Standards employ a bottom-up approach that develops accounting standards based on the differences in the attributes of companies (particularly the differences between listed and large companies and SMEs).

The differences between these two approaches can be organised into the following three points.

Table 29: Differences between the bottom-up approach and the top-down approach

	Top-down approach	Bottom-up approach
1. Method	Selects standards 'appropriate' for SMEs from among existing accounting standards for large companies	Generates 'optimal' standards specifically for SMEs by giving consideration to the needs, requirements, and benefits for SMEs
2. Point of focus	Focuses on 'consistency' with accounting standards for large companies	Focuses on the 'differences in the attributes' of large companies and SMEs
3. Irregular treatments	Views accounting treatments specific to SMEs (ex: simplified practices) as exceptions	Views accounting practices specific to large companies (ex: consolidated accounting and retirement benefit accounting) as exceptions

SMEs = small- and medium-sized entities.

Source: Teruyuki Kawasaki, Division of Accounting Systems and Segmenting of Accounting Standards, *Accounting*, Vol. 186, No. 5, November 2014.

As is clear from Table 29, the top-down approach is a method that selects and extracts content from existing accounting standards which SMEs comply with, while the bottom-up approach involves drafting standards that are both required and would be beneficial to SMEs. As such, generally speaking, the bottom-up approach can be considered the standards most appropriate for SME business management.

The parameters are characterised to establish the current state of SMEs (accounting practices) as rules and standards that are in line with the capabilities of SMEs. In that respect, the Standards enable SMEs to comply without undue burden because they do not mandate high-level accounting practices (tax effect accounting, organisation restructuring accounting, et cetera). Instead, the accounting standards are built by referring to the Guidelines and J-GAAP.

In terms of the correlation between IFRS and IFRS for SMEs, the IFRS for SMEs is built from 35 sections and each section is based on the existing source document (the IAS or IFRS). This means that the IFRS for SMEs can be characterised as a summary version of the IFRS, making it a prime example of standards created based on the top-down approach.

Similarly, Guidelines are based on the top-down approach and are founded on the thought process that regardless of company scale, if the economic principles of transactions are the same, then the accounting practices should be the same. As a result, the Guidelines outline the application of J-GAAP and only as exceptions do the Guidelines allow the application of simplified tax accounting or tax law standards from a cost-benefit perspective[11].

(b) Excluding the influence of IFRS

The Standards clearly outline that they are not influenced by the IFRS. As stated above, the Guidelines were created using a top-down approach based on the IFRS, so any modification to the IFRS requires modification of the Guidelines. This is unlike the Standards, which do not require modifications in such cases. The Standards are modified only when deemed necessary. This is another major difference compared to the Guidelines.

(c) Focus on bookkeeping

The Standards outline the principle of proper bookkeeping in its general provisions and position this ahead of the principle of truth under its usage considerations.

This is a characteristic of formulation based on the attributes of SMEs. SMEs are owner-operated businesses (owner = operator) and the inseparability of ownership and management creates a high risk of false statements. Also, due to having a small number of employees, SMEs do not have internal control organisations and there are no clear divisions of labour so they carry significant governance risks. There is a particular focus on this because accurate and timely bookkeeping is a means of avoiding these types of risks and ensuring the reliability of SME bookkeeping. The goal is to make SME owners aware of their self-management responsibilities and prevent infractions.

(d) Consistency with tax practices

The Standards focus on tax practices that are in line with actual accounting customs. Examples of this include: a) the indication of mandated provision rates as a calculation method for doubtful account reserves; b) recognising the recording of cost valuations (the same as in corporate tax law) as a valuation method for marketable securities; and c) indicating the final inventory cost method as a valuation method for inventory assets. By comparison, the Guidelines limit the use of tax practice treatments to cases where 'there is

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[11] Teruyuki Kawasaki, Division of Accounting Systems and Segmenting of Accounting Standards, *Accounting*, Vol. 186, No. 5, November 2014.

no established accounting practice and tax treatments appropriate to represent facts' or 'when there is no significant difference compared to appropriate accounting treatments'.

(e) Depreciation rules that reflect conditions at SMEs

Unlike the strict depreciation required in the Guidelines, the Standards require equivalent depreciation. Equivalent depreciation is defined as consistent depreciation conducted annually over the length of the service life and recognises methods that differ from strict depreciation if reasonable basis is provided.

(f) Limiting individual items

The current Guidelines have 20 individual items and each of those is defined in detail. Conversely, the Standards, with the aim of simplifying and minimising the items required for SMEs, eliminate rules for tax effect accounting and organisation restructuring accounting to limit the items required for SMEs to a minimum 14 items.

The above six items are the main differences between Guidelines and Standards.

In all cases, the differences represent the differences in the approach to formulation (top-down approach versus bottom-down approach) and the Standards give consideration to the unique conditions of SMEs and place the focus on ease-of-use for SMEs.

(2) Background of evaluations related to SME accounting and reasons

1) Background of evaluations related to SME accounting

As stated above, there are two accounting standards for SMEs in Japan: 'Accounting Guidelines for Small- and Medium-Sized Enterprises' and 'General Accounting Standards for Small- and Medium-Sized Enterprises'. The following table summarises the background behind the establishment of these two different accounting standards.

Table 30: History of SME accounting system in Japan

Month/Year	Event
Mar. 2002	• Study Group on SME Accounting established by the Small and Medium Enterprise Agency (SMEA)
Jun. 2002	• Report of the Study Group on SME Accounting published by the SMEA
Dec. 2002	• Establishment of SME Accounting Standards published by the Japan Federation of Certified Public Tax Accountants' Associations (JFCPTAA)
Jun. 2003	• Research Report on Ideal SME Accounting (Accounting System Committee Research Report No. 8) published by the JICPA
Aug. 2005	• Accounting Guidelines for Small- and Medium-sized Entities (ASBJ Guidelines) published by JICPA, JFCPTAA, the Japan Chamber of Commerce and Industry (JCCI), and the Accounting Standards Board of Japan (ASBJ)
Feb. 2010	• Study Group on SME Accounting re-launched by the SMEA
Mar. 2010	• Council on Accounting Standards of Unlisted Companies established by ASBJ
Aug. 2010	• Report of Council on Accounting Standards of Unlisted Companies published by ASBJ
Sep. 2010	• Interim Report of the Study Group on SME Accounting published by the SMEA
Feb. 2011	• Review Group on SME Accounting and its Working Group established, for which SMEA and FSA served as joint secretariat
Nov. 2011	• General Accounting Standard (Guidelines) for Small- and Medium-sized Entities (Draft) published by the Review Group on SME Accounting for public comments
Feb. 2012	• General Accounting Standard for Small- and Medium-sized Entities published by the Review Group on SME Accounting

FSA = Financial Service Agency; SMEs = small- and medium-sized entities.
Source: Teruyuki Kawasaki, Accounting System for Small- and Medium-Sized Entities, Cyu-ou Keizaisya, 2015.

As indicated in Table 30, the Study Group on Accounting held by SMEA in 2002 was the launching point for the state of accounting for SMEs. Initially, each foundation that heavily invested in SMEs presented their own approaches. This event was noted for having a certain level of disorder. Specifically, in June 2002, the study group published its Report of the Study Group on SME Accounting, which was followed up by the Establishment of SME Accounting Standards published by the Japan Federation of Certified Public Tax Accountants in December 2002. Then, the Japan Institute of Certified Public Accountants published the Research Report on Ideal SME Accounting in June 2003. All of these reports reflected the unique approaches of the respective organisations and the lack of a unified emphasis is believed to have resulted in a certain amount of confusion.

Aiming to eliminate this confusion and develop accounting standards that could be easily used by SMEs, JICPA, JFCPTAA, the Japan Chamber of Commerce and Industry, and the Accounting Standards Board of Japan (ASBJ) conducted a collaborative study that led to the publication of the Accounting Guidelines for SMEs (ASBJ Guidelines) in August 2005. However, as discussed above, the SME Guidelines were a simplified version of the accounting standards created for large companies and their dissemination among SMEs was insufficient.

In light of this situation, SMEA relaunched the Study Group on SME Accounting in February 2010 and the ASBJ established the Council on Accounting Standards of Unlisted Companies in March of that year. This resulted in the SMEA issuing its Interim Report of the Study Group on SME Accounting in September and, in August, the ASBJ published the Council Report on Accounting Standards of Unlisted Companies. These two reports both indicated the need to newly formulate something that reflects the state of accounting practices of SMEs.

In light of these results, SMEA and FSA established a joint office and, in February 2011, created the Review Group on SME Accounting. By examining appropriate procedures for the establishment of accounting standards in February 2012, the group published the General Accounting Standards for Small- and Medium-Sized Enterprises.

Although Japan was early among the Asian countries to achieve economic development, the discussion on accounting standards for SMEs only began as recently as 2002. Having various organisations voice opinions and then unifying to release uniform, independent accounting standards for SME accounting will serve as a point of reference for avoiding confusion among SMEs.

As the original SME accounting standards were based on the top-down approach, taking the initiative to formulate new SME accounting standards using a bottom-up approach once it became clear that the original standards failed to disseminate sufficiently is an example of success in implementing a flexible response.

2) Need for SME accounting

Why was there such a focus in Japan on the formulation of SME accounting standards and what was the catalyst behind this passionate movement? Below, I provide a simple explanation of this topic by dividing it to two issues: the ‘social and economic reasons’ and the ‘intrinsic reasons’.

(i) Social and economic reasons[12]

Studies and research by the SMEA indicated three key issues: the excessive burden of accounting standards; the growing trend towards electronic disclosure of accounting statements; and establishing limits on the burden of proof in disputes.

(a) Excessive burden of accounting standards

Triggered by the growing complexity of social and economic environments and the incorporation of IFRS, Japan introduced a flood of new accounting standards between 1997 and 1999. This greatly increased both the volume and complexity of accounting standards. This came to be referred to in Japan as the ‘accounting big bang’ that resulted in companies incurring great burden while working to comply with complex accounting requirements.

These new accounting standards were mainly accounting standards for large companies (public companies) and they resulted in an overburden of compliance and other problems for SMEs. From the perspective of an SME that had no plans of going public and had no accounting capacity to achieve compliance, there was a need for feasible accounting standards.

(b) Electronic disclosure of accounting statements

From around 2000, the sudden development of information technology (IT) and expansion of network infrastructure led to the dissemination of computers, and disclosure via electronic means was recognised by the Companies Act. This created the need to clarify document

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[12] Ryuji Takeda, SME Accounting, Analysis of the Small and Medium Enterprise Agency "’Report of the Study Group on SME Accounting’, Chuo Keizai-sha, 2003.

creation standards for the SME information subject to disclosure.

(c) Establishing limits on the burden of proof

As in the Western world, it was predicted that Japan would also see an increase in disputes related to accounting information and this would create the need for means to identify limits on the accountability of accounting professionals in relation to disputes.

(ii) Intrinsic reasons[13]

The abovementioned three points outline social and economic reasons for the need to establish SME accounting standards, but other vital reasons for SME accounting standards are seen in the basic differences between large companies and SMEs. Three such points are outlined below.

(a) Separation of ownership and management

In large companies, there is a strong need for ownership to provide an explanation of the state of management in the form of accounting information. Conversely, with SMEs, as ownership and management are often the same, it is sufficient if management has an understanding of the company's accounting. As such, there is no strong need to organise accounting information in a detailed manner for the purpose of external accountability.

(b) Establishment of internal control entity

Large companies have established internal control entities whereas SMEs do not have the human or monetary resources, or are of a scale that does not require creating a system of internal controls in order to ascertain internal status. For these reasons, it is not uncommon for SMEs to have no system of internal control.

As SMEs have no system in place for accumulating accounting information for the purpose of internal control, enforcing the same information handling requirements as large companies would constitute an unreasonable burden.

(c) Scope of stakeholders

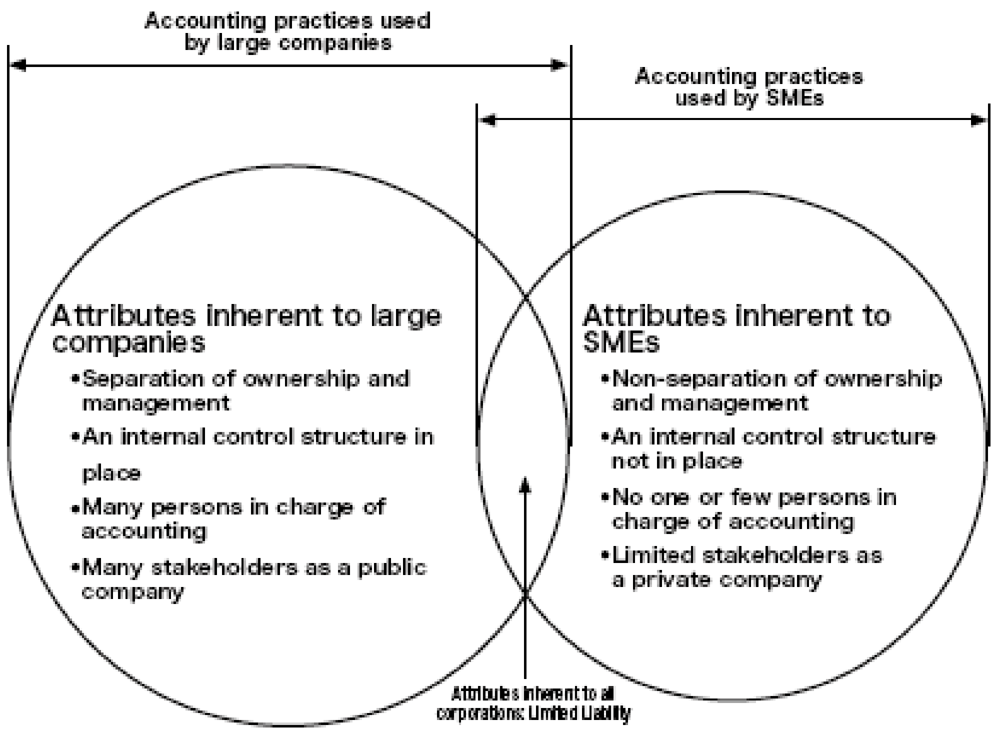
While large companies have a vast range of stakeholders and there is a focus on reflecting the will of investors, SME creditors and transaction partners are limited in both weight and

[13] Teruyuki Kawasaki, Characteristics of Accounting for Small-And Medium-Sized Entities, *Tax and Accounting Research* No. 16, 2005.

number. Thus, there is a greater focus on information provision related to consigned responsibilities. As such, there is limited need for detailed reporting or accountability in terms of the external disclosure of accounting information related to the company's status.

The above types of intrinsic reasons for differences between large companies and SMEs can be summarised in Figure 5.

Figure 5: Assumptions about SME accounting



SMEs = Small- and Medium-Sized Entities.
Source: Teruyuki Kawasaki, Implementation of IFRS (International Financial Reporting Standards) and the Japanese Response - Local Nature of Accounting Culture and the Perspective of the SME, Economic Studies No. 56, Chuo University Institute of Accounting Research, 10 March 2013.

The table on the 'assessment framework' below is the one indicated in the Report of the Study Group on SME Accounting published in June 2002. This represents the conceptual framework (basic concepts) for bookkeeping at SMEs.

The core portions of the assessment framework are presented in comparison to the attributes of SMEs, but it should be carefully noted that the details of this assessment framework are based on the corporate attributes of all SMEs (as it relates to bookkeeping methods, the question of what type of company is the SME, and what its unique characteristics are).

Table 31: Corporate attributes of SMEs and the ‘assessment framework’

<table>
<tr><th>Corporate attributes of SMEs</th><th></th><th>Assessment framework</th></tr>
<tr><td>1. Owner-operated company (owner = management) > risk of false statements</td><td rowspan="6">⇒
Inference</td><td rowspan="2">Bookkeeping (basic approach to bookkeeping)
- Reliable bookkeeping is vital to ensuring the reliability of accounting ledgers
- Bookkeeping must be organised, clear, accurate, comprehensive, and timely</td></tr>
<tr><td>2. Lack of internal control entity
> possibility of control risks</td></tr>
<tr><td>3. Limited accounting knowledge among management/employees
> poor understanding of accounting</td><td>(2) Must be easy for management to understand and the accounting statements created based on this must accurately reflect company status (benefit understanding and operations management)
(4) Must consider current workflows (consideration of workflows)</td></tr>
<tr><td>4. Unable to hire employees with accounting knowledge and management does not see such a need
> limit to economic cost burden</td><td>(3) Must not be an excessive burden on applicable companies (must be feasible) (feasibility)</td></tr>
<tr><td>5. Business type and size diversity
> various types of operations and business</td><td>(5) Accounting practices must have flexibility to reflect company environment and business type. Recognise alternative, simpler methods (flexibility of application)</td></tr>
<tr><td>6. Closed companies with no</td><td>(1) Indicate information that is</td></tr>
</table>

Corporate attributes of SMEs		Assessment framework
intention of going public or stock transfer restrictions > limited stakeholders		beneficial to accounting information users, particularly creditors and transaction partners (limited disclosure)

SMEs = small- and medium-sized entities.
Source: Teruyuki Kawasaki, Meaning and Role of Bookkeeping at Small- and Medium-Sized Entities, *Accounting*, Vol. 176, No. 3, 10 September 2009.

In Japan, based on the above types of fundamental inherent differences in the attributes and circumstances of companies, it was recognised that requiring SMEs to comply with accounting standards outlined for large companies would demand the organisation, submission, and handling of accounting information beyond the realistic requirements of SMEs. As such, there was a need to establish SME accounting standards that did not exert an excessive burden that could negatively impact actual company operations.

(iii) Summarising the need for SME accounting[14]

As indicated above, the accounting issues that apply particularly to SMEs are: ownership and management are inseparable; and companies do not have internal control systems, leading to significant internal control risks. As such, an effective method of resolving these issues is bookkeeping. Here, bookkeeping refers to the accurate and timely creation of accounting ledgers. To achieve the accurate and timely creation of accounting ledgers, it is vital that SME owners have an awareness of the importance of bookkeeping and that the role of bookkeeping is to make SME owners aware of their self-management responsibilities and prevent infractions.

The Report of the Study Group on SME Accounting in 2002 contained three major points in relation to the requirements for bookkeeping.

- Organised and clear (order and clarity): The requirement that the accounting records be documented in a way that provides creditors and other stakeholders with a clear understanding. Specifically, it requires the use of easily understood methods for

[14] Teruyuki Kawasaki, Meaning and Role of Bookkeeping at Small- and Medium-Sized Entities, *Accounting*, Vol. 176, No. 3, 10 September 2009.

indication of information, including accounting record format, information categories, item names, and order of arrangement.

- Accurately and comprehensively (accuracy and completeness): The requirement that records be factual and have no embellishments.
- Timely (timeliness): The requirement that information be recorded immediately after the discovery of a matter of record and the daily recording of transaction based on the fact that the possibility for recording errors increases as time passes.

(3) Approach to SME accounting and fundamental system

As referred to in (1) and (2), in Japan, the two types of SME accounting—Guidelines and Standards—are the results of historical developments and social and economic factors. At present, the Standards—which were created using the bottom-up approach and which enable accounting that is both required of and beneficial to SMEs—are being disseminated gradually.

In Japan, while it can be said that bookkeeping and the creation of accounting records by SMEs are relatively advanced, it is important to note that there is a framework and an approach to proper bookkeeping for SMEs. Numerous aspects may be of reference when promoting initiatives related to SME bookkeeping and accounting in ASEAN countries. A simple summary is provided below.

1) Main differences between Japanese and international accounting models[15]

First, there are fundamental differences in accounting between Japanese and international accounting models. Specifically, these are: (i) the positioning of consolidated financial statements; (ii) the need for tax effect accounting; and (iii) the approach to market value accounting. The aspects that characterise the Japanese accounting system are summarised below.

(i) Positioning of consolidated financial statements

In the past, the principal financial statement for Japanese companies was the parent company financial statement, and the consolidated financial statement related to the corporate group

[15] Teruyuki Kawasaki, Implementation of IFRS and the Japanese Response - Local Nature of Accounting Culture and the Perspective of the SME, *Economic Studies* No. 56, Chuo University Institute of Accounting Research, 10 March 2013.

had merely a supplemental role. However, today, with the IFRS convergence, consolidated financial statements have become the principal format for financial statements.

(ii) Need for tax effect accounting (use of the principle of congruency)

In the past, Japan maintained the principle of congruency, which comprised of a structure of calculating taxable income based on confirmed accounting (financial statements). As a result, tax effect accounting (adjustment of calculated taxable income and the tax assessment) was not deemed necessary. A major difference compared to the UK and the USA, however, is the separation of the tax calculations used for accounting and the calculation of taxable income required tax effect accounting.

In Japan, the principle of congruency is addressed by Article 74 of the Corporation Tax Act, which stipulates that tax filings must be created and submitted based on finalised corporate accounting. This means that taxable income shall be calculated based on corporate income that is based on accounting, as defined under Articles 438 and 439 of the Companies Act, and this shall be known as the 'principle of congruency'.[16] As such, this framework is defined in the Corporation Tax Act and the Companies Act.

The merits of the principle of congruency are described below.

Table 32: Merits of the principle of congruency in Japan

Category	Merit	Explanation of merit
Formal	Simplification of taxable income calculations	Establishing a foundation for calculating taxable income on corporate income indicated in finalised accounting eliminates the need to calculate taxable income separately from corporate income calculations, which simplifies the process of calculating taxable income. Also reduces tax collection costs incurred by the tax bureau.
	Ensures legitimacy of tax filings	Using accounting statements approved by the general meeting of shareholders is expected to guarantee the legitimacy of tax filings
Intrinsic	Simplification of tax system	Calculating taxable income based on generally accepted accounting practices can eliminate the need to outline detailed rules for taxable income calculation methods in the tax code.

Source: Convergence of Accounting Standards and the Principle of Congruency, Report by the Study Group on Tax Adjustment No. 20, Japanese Institute of Certified Public Accountants, 15 June 2010.

[16] Kazuo Masuda, About the Principle of Congruence, *Commerce Studies Research* Vol. 48, No. 2-3, 2008.

The principle of congruency is a framework that does not exist in international accounting models and is seen as an obstacle to implementing IFRS. However, it is also argued that there is logical basis for the existence of this principle based on the regional cultural characteristics of Japan, and is said to originate in the character of 'law' as it related to Japanese accounting systems. The major difference is that while the Companies Act belongs to a system of laws that regulate the standing between equal individuals (private law), the tax code belongs to a system of laws that regulate the relationship between an entity with public power (country) and its subordinate (public law). However, the parties targeted for the application of these laws is the same, meaning that the Companies Act takes on the characteristic of a fundamental law in relation to the tax code. As a result, in principle, the calculation of taxable income in accordance with the tax code must be dependent on the calculation of income in accordance with the Companies Act.

In either case, the Japanese accounting system is operated based on the principle of congruence and, considering the fact that the main interest in SME accounting and finances relates to the calculation of taxes, this discussion cannot be held without considering an approach to the principle of congruence, which is an inexpensive and effective method of calculation.

(iii) Approach to market-value accounting

The IFRS approach uses market-value assessments of assets and liabilities to assess the overall corporate value (asset-liability approach) while the conventional Japanese accounting approach bases the calculation of income and assets on an assessment of procurement costs (income-expenditure approach).

In particular, the goal of market-value accounting is accounting that indicates usefulness of stock purchases, corporate mergers and acquisitions, et cetera during investment decisions, and the scope. While it depends on the scope and industry, given that stock transactions and mergers and acquisitions are relatively uncommon for SMEs, there are suggestions that accounting that indicates the execution of consigned responsibilities (cost-based accounting) is more appropriate for SMEs.

2) Methodological traits of SME accounting in Japan

Generally speaking, the formulation of accounting standards can be categorised into two approaches. One is the functional theory approach and the other is the mechanical theory approach.

(i) Functional theory approach

Accounting standards are viewed as having a specific purpose, with all standards functioning in unison. The target of such standards is identified from a functional perspective.

As shown in Figure 6, if accounting is viewed as the workflow of bookkeeping (input) > accounting system (awareness/measurement: process) > financial statements (output), the functional theory approach is the method that considers the state of the accounting system based on financial statements (output).

The IFRS represents accounting standards founded on this approach and lends to discussing the state of accounting standards based on the idea that the role of financial statements is to indicate effectiveness (of stock purchases, mergers and acquisitions, et cetera) during investment decisions.

(ii) Mechanical theory approach

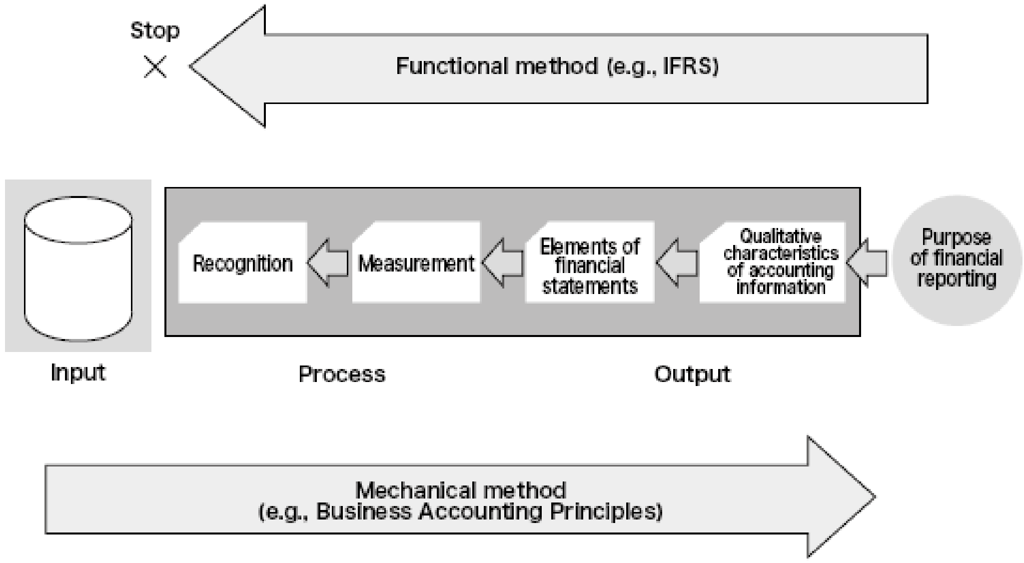
This approach refers to an analytical breakdown of accounting standards to identify the nature of specific parts, and then gathering those parts to restructure the target of those standards.

As shown in Figure 6, if accounting is viewed as the workflow of bookkeeping (input) > accounting system (awareness/measurement: process) > financial statements (output), the mechanical theory approach is the method that considers the state of the accounting system based on bookkeeping (input).

The General Accounting Standards for SMEs are rooted in this approach, and exist as a system of accounting standards that emphasises the ‘principles of authentic bookkeeping’.

Focusing on the importance of bookkeeping (competence of records) as the foundation of accounting is vital for SMEs, which lack internal control entities. As such, it can be said that the mechanical theory approach is more appropriate than the functional theory approach in terms of establishing accounting standards for SMEs.

Figure 6: Functional theory approach and mechanical theory approach



IFRS = International Financial Reporting Standards.
Source: Teruyuki Kawasaki, Implementation of IFRS and the Japanese Response, Local Nature of Accounting Culture and the Perspective of the SME, *Economic Studies* No. 56, Chuo University Institute of Accounting Research, 10 March 2013.

(iii) Blue Return System

In Japan, there is a tight correlation between accounting and bookkeeping. Particularly for SMEs, the creation of financial statements is extremely important for tax returns. Another unique element of Japanese accounting and taxation systems is the Blue Return System.

The Blue Return System is a system in which the business obtains approval from the tax bureau and then files a blue tax return form to which is attached specific required documents. Selecting the blue tax return comes with the requirement that appropriate bookkeeping is conducted according to specific regulations, but the merits include 1) various tax incentives (Blue Tax Return deduction, deferred deduction of losses, various special deductions, expense accounting for wages paid on workers of sole proprietorships, et cetera); and 2) the bookkeeping content is prioritised—meaning, the tax bureau cannot arbitrarily estimate tax assessments (bookkeeping competence). In exchange for appropriate bookkeeping, this system allocates the taxpayer certain incentives related to the calculation of income and taxes, as well as with tax assessment procedures. As such, diligent bookkeeping results in lower taxes and no unjustified additional assessments by the tax bureau.

This system can be evaluated as having served a certain role by promoting appropriate bookkeeping and stabilising the tax return system during the chaos following WWII when it was common for people to not file and under-report. On the enforcement side, this system improved what had become a vicious cycle of filing > correction > additional correction > objection, and contributed to streamlining tax administration.

The Blue Return System was established in 1950 in accordance with Shoup's recommendations. But initially, until the period when it became customary for businesses to conduct bookkeeping, the system was viewed as excessive and it was not viewed as a permanent solution. However, more than 60 years have passed since the adoption of this system. It is a well-known system and has solidified its role as a system for promoting appropriate bookkeeping and tax return filing. As such, today, the system is so ingrained in Japanese companies that it is basically viewed as a permanent fixture[17].

The use of the abovementioned principle of congruence in Japan (the system of calculating taxes based on accounting statements finalised in accordance with the commercial code and the Companies Act) also provides the benefit of filing tax returns and creating financial statements required by the commercial code and the Companies Act simultaneously. It is worth noting that this Blue Return System, which has specific economic merits and the ability to create tax filings and financial statements based on the principle of congruence with minimal burden, has been key to promoting appropriate bookkeeping in Japan.

As a result of the joint promotion of the Blue Return System by both public and private entities in Japan, nearly all sole proprietorships select to file using the Blue Return System (over 90 percent for corporate taxes) and are conducting bookkeeping. Thus, of all countries with value-added tax, Japan is the only country that calculates income taxes based on bookkeeping and not invoices. The Blue Return System has enabled the total permeation of bookkeeping-based accounting. This can be viewed as a policy that improves companies through accounting.

4) Meaning and role of bookkeeping in SMEs[18]

(i) Post WWII focus on rebuilding the economy

Looking back at the history of bookkeeping and accounting in Japan, its roots can be traced

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[17] Japan Federation of Certified Public Tax Accountants' Association, State of the Blue Return System, March 2012.

[18] Teruyuki Kawasaki, Meaning and Role of Bookkeeping at Small- and Medium-Sized Entities, Accounting, Vol. 176, No. 3, September 2009.

to the Bookkeeping Standards for Small- and Medium-Sized Enterprises released in 1949 by the Economic Stability Committee Study Group on Corporate Accounting System Policies.

Originally, the need for accurate bookkeeping was being emphasised as a prerequisite to the adoption of the Blue Return System, which resulted in the drafting and publication of the Bookkeeping Standards for Small- and Medium-sized Enterprises. These bookkeeping standards were created with the following three objectives.

Table 33: Main purposes of the bookkeeping standards for small- and medium-sized enterprises

1. Enable accurate self-calculation of income and contribute to the optimisation of taxation.
2. Contribute to the streamlining of SME financing by clarifying business accounting details for financing decisions.
3. Promote awareness of the state of business finances and performance, and the use of actuarial benchmarks to enable the optimisation of business management.

Source: Economic Stability Committee Study Group on Corporate Accounting System Policies, Bookkeeping Standards for Small- and Medium-Sized Enterprises, in cooperation with the Ministry of Finance, 1950.

As these three objectives aligned with the objectives for establishing business accounting principles drafted and announced that same year, we can see that the optimisation of taxation, streamlining of financing, and optimisation of business management were vital issues for both large companies and SMEs as it related to rebuilding a Japanese economy that was in shambles after WWII.

As such, dissemination and awareness among SMEs of the double-entry bookkeeping that served as the foundation for creating accurate accounting ledgers was positioned as an urgent issue.

(ii) General principles of guidelines for SMEs

The previously mentioned Bookkeeping Standards for Small- and Medium-Sized Enterprises outlined seven general principles[19].

[19] Economic Stability Committee Study Group on Corporate Accounting System Policies, Bookkeeping

Table 34: Seven Principles of Bookkeeping Standards for Small- and Medium-Sized Enterprises

	Principle	Description
1	Principle of authentic bookkeeping	Bookkeeping must entail the creation of accurate accounting records based on the principle of authentic bookkeeping for all transactions related to changes in business assets, liabilities, and capital.
2	Principle of truth	Bookkeeping must provide a truthful report of the status of business finances and performance.
3	Principle of clarity	Bookkeeping must use financial statements to clearly indicate necessary accounting facts to stakeholders and must not promote false perceptions regarding the status of business.
4	Principle of the separation of business and household accounting	Bookkeeping must clearly record business transactions and must be separated from household finances.
5	Principle of continuity	Bookkeeping must continuously apply specified accounting practices and may not be changed randomly.
6	Principle of revenue assessments, principle of incurred costs	Major expenses and income such as purchases and sales must be recorded based on actual expenditures and revenues, and must be allocated accurately to the period during which they occurred.
7	Principle of bookkeeping efficiency and burden reduction	As long as bookkeeping fulfils the abovementioned parameters, accounting principles and record structures should be simplified to promote bookkeeping efficiency and the reduction of bookkeeping burden.

Source: Bookkeeping Standards for Small- and Medium-sized Enterprises, Economic Stability Committee Study Group on Corporate Accounting System Policies, in cooperation with the Ministry of Finance, 1950.

In the Bookkeeping Standards for Small- and Medium-Sized Enterprises, the number one principle is considered the principle of authentic bookkeeping. This is based on the fact that the standards represent bookkeeping parameters and thus, the principle of truth and other principles are positioned as general principles for the creation of accurate accounting records[20].

Standards for Small- and Medium-Sized Enterprises, in cooperation with the Ministry of Finance, 1950.

[20] Moriyama Shoten, Economic Stability Committee, Bookkeeping Standards for Small- and Medium-

The principle of the separation of business and household accounting and the principle of bookkeeping efficiency and burden reduction are principles that do not exist in accounting principles for large companies. The principle of the separation of business and household accounting is based on the fact that with SMEs, typically, ownership and management are inseparable (owner = management). Thus, there is a need to separate this relationship. As for the principle of bookkeeping efficiency and burden reduction, SME management and employees often lack accounting knowledge or there is a cost limit related to hiring employees with accounting knowledge. As such, there is a need to require the simplification of accounting practices and record structures. These points that are unique to SMEs are matters that should be a point of focus when developing and expanding accounting systems and customs in ASEAN where various countries are experiencing rapid economic growth.

Furthermore, the Bookkeeping Standards for Small- and Medium-Sized Enterprises states that, in relation to the difficulty of SME bookkeeping, ‘SME bookkeeping should be a simple process with as few steps as possible and should consist of records that validate the accuracy of bookkeeping, even during a simple audit of bookkeeping records by a third party such as the Tax Bureau or the Finance Bureau, and as such, there is the issue of how these two points will be evaluated.’ This indicates the emphasis on achieving a balance of simplicity and accuracy for SME bookkeeping and accounting systems in Japan.

(4) Conclusion

Compared to other Asian countries, Japan achieved economic development at a relatively early stage and today conducts global transactions with western countries. However, the application of IFRS is voluntary and there are two accounting standards for SMEs in Japan: the Accounting Guidelines for Small- and Medium-Sized Enterprises and the General Accounting Standards for Small- and Medium-Sized Enterprises. The internationally-influenced Guidelines lack sufficient dissemination while the dissemination of the General Accounting Standards for Small- and Medium-Sized Enterprises, which are not influenced by the IFRS, is gaining traction.

The General Accounting Standards for Small- and Medium-Sized Enterprises are accounting standards that were drafted based on a bottom-up approach. They give consideration to the business characteristics of SMEs and the purpose of bookkeeping. They were created in the

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Sized Enterprises with Bookkeeping Examples,1950.

format that is most optimal for SMEs. In this sense, they differ from accounting standards created using a top-down approach that are modifications of accounting standards for large companies. As such, they are incredibly easy to adopt from the perspective of the SME.

The background of these General Accounting Standards for Small- and Medium-Sized Enterprises is rooted on the following: that SME ownership and management are inseparable; SMEs do not have established internal controls; and the scope of SME stakeholders is limited. This approach is founded on the need for accounting that recognises the differing attributes of companies.

The importance of accounting for SMEs lies in the input, the initial actions related to accounting. In other words, it is important to note that these standards focus on the keeping of records and enable the timely and accurate recording of business activities as well as the use of that information towards improvements to management. In this sense, this differs from accounting that emphasises the results of business activities (output).

Also, these standards place significant emphasis on reducing the burden related to SME tax returns and financial statement creation, as well as consistency with tax procedures, and upholding the principle of congruence. This directly ties tax return creation to the creation of financial statements, which leads to reduced time and monetary burden. Also, the use of the Blue Return System to create timely and accurate bookkeeping records in accordance with bookkeeping rules enables businesses to receive incentives. It cannot be ignored that the adoption of this system has provided economic benefits to Japanese SMEs while promoting bookkeeping and accounting activities.

Lastly, it should be noted that the history of SME-specific accounting standards in Japan is not very old, and it is still in the period of dissemination. It is likely that the ASEAN countries working on initiatives to establish bookkeeping and financial statement creation systems that comply with SME accounting standards can reference the efforts of the SMEA, FSA, and accounting professionals in Japan who have partnered on promotional initiatives.

2. China

(1) Recent Movements regarding Accounting for SMEs

At the first tier of the Chinese accounting system is the Accounting Act (1985). Below that is the Business Entities Financial Reporting Regulation (2001), which governs the Accounting Guidelines for Business Entities – Basic Guidelines (2007). In addition, in 2007, the Accounting Guidelines for Business Entities – Detailed Guidelines became applicable to listed companies and financial entities. The Guidelines are based on IFRS, with some deletions and additions, and has been assessed as comparable by the European Union (EU) since 2012.

On the other hand, China had the Accounting System for Small Entities, the accounting standard for SMEs, which was developed by the Chinese Ministry of Finance in 2005. However, in 2011, the Accounting Guidelines for Small Entities was promulgated and then put into force on 1 January 2013. Accordingly, the Accounting System for Small Entities was abolished and now, only the Accounting Guidelines for Small Entities is in force. The movements towards the introduction of the Accounting Guidelines for Small Entities started after the IFRS for SMEs was published by IASB in July 2009, and it can be inferred that the Chinese accounting authority is somewhat following in the footsteps of IASB.

(2) Characteristics and Contents of the Accounting Guidelines for Small Entities

In accordance with the Interpretation of the Accounting Guidelines for Small Entities, the Accounting Guidelines for Small Entities shall be, in accordance with the Accounting Act, applied to small entities in China. Considering that the operations of small entities are on a small scale, their business activities are of a simple nature, there are few specialists dealing with accounting for small entities, and the needs from the users of their accounting information are relatively similar, the Accounting Guidelines for Small Entities should be of a more simple structure. Thus, the main body of the Accounting Guidelines for Small Entities is comprised of 10 chapters, 90 articles and 1 appendix as seen below:

- Chapter 1: General Rules (Articles 1 to 4)
- Chapter 2: Assets (Articles 5 to 44)
- Chapter 3: Liabilities (Articles 45 to 52)
- Chapter 4: Equity Interest (Articles 53 to 57)

- Chapter 5: Revenues (Articles 58 to 64)
- Chapter 6: Expenses (Articles 65 to 66)
- Chapter 7: Profits and Appropriation of Profits (Articles 67 to 72)
- Chapter 8: Foreign Currency Handling (Articles 73 to 78)
- Chapter 9: Financial Reporting (Articles 79 to 88)
- Chapter 10: Supplementary Provisions (Articles 89 to 90)
- Appendix: Accounting Calculation, Major Book Processing and Financial Reporting.

Another reason for the introduction of the Accounting Guidelines for Small Entities is to ensure coordination with the Corporate Income Tax Act. Therefore, in areas such as criteria for measuring assets, service life, residual value, depreciation and amortisation; methods and periods for allocation of long-period costs; recognition of loss on assets; method for foreign currency translation; and method for calculating corporate income tax, there is consistency between the Accounting Guidelines for Small Entities and the Corporate Income Tax Act.

As for the definitions of small enterprise, the Ministry of Industry and Information Technology, the National Bureau of Statistics, the National Development and Reform Commission, and the Ministry of Finance have developed the Regulations Concerning Criteria for Distinguishing Small- and Medium-Sized Entities, which provides the following definitions per industry:

The small entities mentioned above are entitled to use the Accounting Guidelines for Small Entities. However, small entities that fall under any one of the following three types are excluded from the application:

- Entities whose stock or bonds are listed and traded on the securities market;
- Financial institutions and other entities engaging in activities similar to those of financial institutions; or
- Parent company or subsidiary belonging to the same group.

According to the Development Conditions of Small Entities, a report published at the China International Convention on SMEs held in 2009, at the end of 2008, there existed 4,770 thousand small entities all over China. This represents 97 percent of all business entities in China. In terms of the number of employees, small entities account for 53 percent; in terms of major operating revenues, 39 percent; and in terms of total assets, 42 percent.

Table 35: Definitions of Small Entities in China

Industry Category	No. of employees	Operating Revenues	Total Assets
Agriculture, forestry and fishing	—	less than ¥ 5 million	—
Manufacturing	less than 300	less than ¥ 20 million	—
Construction	—	less than ¥ 60 million	less than ¥ 50 million
Wholesale	less than 20	less than ¥ 50 million	—
Retail	less than 50	less than ¥ 5 million	—
Transportation	less than 300	less than ¥30 million	—
Warehousing	less than 100	less than ¥10 million	—
Postal Service	less than 300	less than ¥20 million	—
Hotel	less than 100	less than ¥20 million	—
Restaurant	less than 100	less than ¥20 million	—
IT	less than 100	less than ¥10 million	—
Software/Information Technology Service	less than 100	less than ¥10 million	—
Real Estate Development	—	less than ¥10 million	less than ¥50 million
Real Estate Management	less than 300	less than ¥10 million	—
Lease/Commercial Service	less than 100	—	less than ¥80 million
Others	less than 100	—	—

IT = Information Technology; ¥ = Chinese Yuan Renminbi.
Source: Tao Jing, A study of small business accounting standards in China, Doshisha Shogaku (The Doshisha Business Review), 2014.

(3) Differences between the Accounting Guidelines for Small Entities and the IFRS for SMEs

It is said that the Accounting Guidelines for Small Entities intends to ensure convergence to the IFRS for SMEs. However, the volume is much lighter than that of the IFRS for SMEs. As mentioned earlier, while the Accounting Guidelines for Small Entities comprise 10 chapters, 90 articles and 1 appendix, the body alone of the IFRS for SMEs consists of 35 sections and contains as much as 232 pages. In addition, the Guidelines have provisions setting forth simplifications of accounting procedures. For example, the assets of small entities are to be accounted for at historical cost and no impairment adjustments are required (Article 6). Further, account processing on the side of the lessee of a finance lease is in accordance with the Simplified Valuation Method. More specifically, the acquisition cost of a lease asset is the total of the aggregate amount of a lease contract and relevant ancillary expenses, and no calculation for discounting the future cash flows to the present value is required (Article 28). Tax effect accounting is not used either (Article 71). However, there is no essential difference with respect to major concepts such as assets, liabilities, equity interest, revenues, and expenses.

(4) Conclusion

In China, while listed companies are subject to an accounting standard almost comparable to the full IFRS, a separate accounting standard specifically designed for small entities has been introduced. The definitions of small entities are as mentioned earlier, and it can be said they are SMEs in a general sense. In designing the accounting standard for small entities, emphasis was placed on the following two points: (i) procedures should be considerably simplified in light of actual situations around small entities; and (ii) coordination with the tax system should be ensured as much as possible. These ideas are similar to those underlying the Japanese guidelines for SME accounting, and would also serve as an important reference for other countries in considering their SME accounting standards.

3. Korea

(1) Recent Movements regarding Accounting for SMEs

From the historical point of view, the Korean accounting system has been developed by inheriting the Japanese accounting system. However, in 2007, the Korea-Adopted International Accounting Standard (K-IFRS) was announced officially by the Korean Accounting Institute/the Korean Accounting Standards Board (KAI/KASB). Then, by 2013, all the listed companies have been compulsorily covered by the Standards. The K-IFRS is basically the translated version of the full IFRS and its comparability to the full IFRS has been recognised by the EU. As a background, Korea received emergency support from the IMF and the International Bank for Reconstruction and Development (IBRD) during the financial crisis in 1997. At that time in Korea, accounting frauds and corporate bankruptcies occurred one after another and this situation led to increased public distrust of the accounting system. In this context, the Korean government promised the IMF and IBRD that they would reform their accounting system.

On the other hand, the adoption of the K-IFRS for unlisted companies was left to the discretion of the respective companies. In Korea, discussions were held on whether to adopt the IFRS for SMEs as the accounting standard for unlisted companies or to introduce a more simplified version of their conventional accounting standard, the Korean Corporate Accounting Standard (K-GAAP). In 2008, the KAI/KASB published a report, Developing Accounting Standards for Non-Public Entities in Korea, where they compared the then current exposure draft of the IFRS for SMEs and the K-GAAP. The report argued that the IFRS for SMEs was preferable from the point of view of convergence with international standards, but when it comes to cutting the accounting burden for SMEs, the ease of dealing with emerging requirements and reflecting Korea-specific businesses in the case of any unexpected turn of events, the K-GAAP was more suitable. Further, the report contended that since there was also the option for unlisted companies to adopt the K-IFRS, there would be no problem if unlisted companies wishing to attract investments on a global scale chose to use the K-IFRS. Therefore, it would not be justifiable that even unlisted companies with no need for international credibility or comparability were also covered by the IFRS for SMEs since ensuring compliance with the standard would not be an easy job. The report concluded that it would be preferable to maintain the K-GAAP after making some necessary adjustments. Based on the above arguments, in 2009, the General Corporate Accounting Standard, which is the simplified version of the K-GAAP, was published and then adopted. However, it should be noted that the KAI/KASB is expressing its intention to adapt the General Corporate Accounting Standard to the IFRS for SMEs in the long run.

Although the General Corporate Accounting Standard was announced officially, SMEs in Korea found it difficult and a serious burden on them to adopt even the standard. It is said that the accounting for SMEs is in fact merely tax accounting for the purpose of facilitating tax payments. In this context, in 2013, in order to alleviate the burden on SMEs facing difficulties in adopting even the General Corporate Accounting Standard, the Accounting Standard for SMEs was announced officially by the Korean Ministry of Justice and then enforced in 2014. The Accounting Standard for SMEs is actually the simplified version of the General Corporate Accounting Standard.

As seen above, the Korean accounting system has a three-level structure that, while listed companies are compulsorily covered by the full IFRS, on the other hand, there are two types of accounting standards applicable to unlisted companies. Another characteristic of the Korean system is that they have not merely introduced a copy of the IFRS for SMEs as accounting standards for unlisted companies.

(2) Characteristics and Contents of the Standards for Unlisted Companies

As mentioned earlier, there are two types of accounting standards for unlisted companies: the General Corporate Accounting Standard; and the Accounting Standard for SMEs. Their respective scopes are illustrated below. For example, a small-scale unlisted company may adopt the K-IFRS, but once it chooses to use the K-IFRS, it will never be allowed to shift its accounting standard to the General Corporate Accounting Standard or the Accounting Standard for SMEs.

Table 36: Accounting Standard Options for Korean Companies

<table>
<tr><th>Listed/Unlisted</th><th>Assets Size/Audit Requirements</th><th colspan="3">Accounting Standard Options</th></tr>
<tr><td>Listed Companies</td><td>—</td><td></td><td></td><td rowspan="3">K-IFRS</td></tr>
<tr><td rowspan="2">Unlisted Companies</td><td>₩10 billion or more (subject to external audit)</td><td></td><td rowspan="2">General Corporate Accounting Standard</td></tr>
<tr><td>less than ₩10 billion (not subject to external audit)</td><td>Accounting Standard for SMEs</td></tr>
</table>

K-IFRS = Korea-Adopted International Accounting Standard; SMEs = small- and medium-sized entities; ₩ = South Korean Won.
Source: Teruyuki Kawasaki, Accounting System for Small- and Medium-Sized Entities, Chuo Keizai sya, 2012.

The General Corporate Accounting Standard is based on the following policies:

- The current accounting standards (K-GAAP) should be maintained;
- The contents of the standard should be simplified for the purpose of alleviating the burden of preparing financial statements; and
- Appropriate consideration should be paid to conformity with international rules.

The General Corporate Accounting Standard was designed so that the K-GAAP, the conventional accounting standard, would be maintained but in a more simplified version. The standard was also developed using a top-down approach. However, it should be noted that it has been publicly announced that the standards will be adapted to the IFRS for SMEs in the long run. To what extent the General Corporate Accounting Standard should be converged to the IFRS for SMEs seems to be left to future discussions.

The Accounting Standard for SMEs is the further simplified version of the General Corporate Accounting Standard, and is also developed using a top-down approach. The Standard has a very compact structure, comprising 10 chapters, 50 articles and 2 articles of supplementary provisions. The KAI/KASB, which is responsible for the formulation of the standards, has commented, 'With emphasis on transactions most commonly observed among SMEs, the Standard has been structured by simplifying the General Corporate Accounting Standard'. As a method for asset valuation, the historical cost basis has been adopted in principle. In this respect, the Standard is clearly different from the IFRS for SMEs and rather comparable to the Japanese Accounting Guidelines for SMEs.

(3) Conclusion

In Korea, while listed companies are compulsorily covered by the K-IFRS (comparable to the full IFRS), there are two types of accounting standards for unlisted companies: the General Corporate Accounting Standard and the Accounting Standards for SMEs. Neither of these two standards has been developed based on the IFRS for SMEs but they have both been designed (using a top-down approach) to be the simplified versions of the conventional accounting standard, the K-GAAP. The Korean accounting standards are characterised by the following three points: (i) the accounting standards system is of a three-level structure; (ii) the standards for unlisted companies have not been developed based on the IFRS for SMEs; and (iii) the standards for unlisted companies have been developed using a top-down approach by simplifying the conventional accounting standard, the K-GAAP.

Especially in connection with point (ii), it is interesting to note KAI/KASB's comment as follows: 'Since there was also the option for unlisted companies to adopt the K-IFRS, there would be no problem if unlisted companies wishing to attract investments on a global scale choose to use the K-IFRS and, therefore, it would not be justifiable that even unlisted companies with no need for international credibility or comparability were also covered by the IFRS for SMEs since ensuring compliance with the standard would not be an easy job'. This stance could serve as an important reference for other countries when they consider their accounting standards for SMEs.

4. United States of America

(1) Recent trends concerning SME accounting in the United States

No specific accounting standard for SMEs exist in the United States of America (US). However, in spite of such a situation, efforts to establish accounting standards for SMEs were made in the US as well in response to the introduction of IFRS in various countries. Following the establishment of the Private Company Financial Reporting Committee (PCFRC) by the Financial Accounting Standard Board (FASB) in 2006, consideration continued.

As for recent developments, in 2012, the Financial Accounting Foundation (FAF) established the Private Company Council (PCC) and published the Private Company Decision-making Framework as materials for discussions. On the other hand, the American Institute of Certified Public Accountants (AICPA) totally and independently published a draft of the Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs) in 2012. This draft was officially published in 2013.

One of the characteristics of efforts in the US is that several ideas of accounting standards for SMEs were suggested. They were not necessarily integrated into one. As of 2015, there were three accounting standards for SMEs in the US: IFRS for SMEs; FRF for SMEs; and GAAP for SMEs. Differences among these are as follows:

Table 37 : Accounting standards for SMEs in the US

	IFRS for SMEs	GAAP for SMEs	FRF for SMEs
(1) Establishing organisation	IASB	PCC of FAF	AICPA
(2) Status	Released in 2009	Pending (Guidance presented in 2013)	Released in 2013
(3) Target	✓ Corporations intending to expand business overseas ✓ Corporations intending to procure funding from international investors	✓ Corporations with a large amount of loans from financial institutions ✓ Corporations intending to go public	Privately held companies not obliged to disclose their financial statements
(4) Overview	✓ Simplification of full IFRS to suit SMEs	✓ Simplification of US GAAP to suit privately held companies	✓ Integration of the current taxable income calculation into the traditional accounting principle ✓ Officialisation of other accounting standards (OCBOA21)
(5) Characteristics	✓ Focus on cash flow and liquidity ✓ Adoption of the approach to assets and liabilities focused on balance sheets	✓ Elimination of the complexity of US GAAP ✓ Difficulty of becoming an international standard	✓ Reduction of reporting ✓ Easy to understand ✓ Reduction of costs for preparation
(6) Approach	✓ Top-down approach	✓ Top-down approach	✓ Bottom-up approach

AICPA = American Institute of Certified Public Accountants; FAF = Financial Accounting Foundation; FRF = Financial Reporting Framework; GAAP = Generally Accepted Accounting Principles; IASB = International Accounting Standards Board; IFRS = International Financial Reporting Standards; OCBOA = Other Comprehensive Basis of Accounting; PCC = Private Company Council; SMEs = small- and medium-sized entities; US = United States of America.
Source: Hoffelder, Kathleen, Mind the GAAP Alternative, CFO Magazine, September 2012, as supplemented and revised.

We will carefully analyse FRF for SMEs, which has been already released as a standard and is based on different ideas from those of IFRS for SMEs, to explain how SME accounting is recognised in the US and what is the goal of the establishment of FRF for SMEs.

[21] OCBOA includes tax law basis, cash basis and modified cash basis, whose adoption is determined according to the needs and costs of users of financial statements of SMEs.

(2) Characteristics and contents of FRF for SMEs

1) Positioning of FRF for SMEs

FRF for SMEs was released by AICPA in 2012. As AICPA itself is not authorised to enforce the adoption of accounting standards, FRF for SMEs is a standard which can be used voluntarily. However, business owners who prepared financial statements in accordance with FRF for SMEs can state that their financial statements are in accordance with FRF for SMEs, which is a framework for special purposes.[22].

2) Target of FRF for SMEs

One characteristic of FRF for SMEs is the establishment of criteria of target companies. Based on the assumption that companies that will use FRF for SMEs cannot be defined by the number of employees, sales amount and capital amount, et cetera, the target companies are defined as follows:

- A company under no obligations to report financial statements in accordance with the US GAAP.
- A privately held company whose owners and managers have no intention of going public.
- Its owners and managers evaluate performance, cash flow, possession of own shares, and borrowings on the basis of financial statements.
- Its business is not complex to a reasonable extent, and it is not actively operating business overseas.
- Users of financial statements are greatly interested in cash flow, liquidity, financial conditions, and interest coverage.

3) Characteristics of FRF for SMEs in terms of accounting

(i) Characteristics seen from the conceptual framework

Chapter I of the FRF for SMEs on Concepts of Financial Statements is composed of the purpose of financial reporting, qualitative characteristics of accounting information, components of financial statements, and recognition standards and measurement. This chapter provides a conceptual framework for FRF for SMEs. To clarify the characteristics of

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22 AICPA, Financial Reporting Framework for Small- and Medium-Sized Entities, 2013.

FRF for SMEs in terms of accounting, major points of the said chapter are summarised as follows:

Table 38 : Conceptual Framework of FRF for SMEs

Items	Main contents
1. Purpose of financial reporting	(1) Purpose of financial statements: To transmit information useful for users when users (that is, managers, creditors and other users) make decisions on allocation of resources, and/or when the managers' fiduciary duties are evaluated (2) Information presented by financial statements: (i) Economic resources, debts, and equity interests of the company; (ii) Changes in economic resources, debts, and equity interests of the company; and (iii) Economic performance of the company
2. Importance and qualitative characteristics	(1) Qualitative characteristics: (i) Understandability; (ii) Suitability for purposes (predictive value, feedback value, and timeliness); (iii) Reliability (integrity, verifiability, and neutrality conservatism of expressions); and (iv) comparability (2) Trade-off between the qualitative characteristics: especially between suitability for purposes and reliability (3) Expert judgment: importance
3. Components of the financial statements	(1) Two types of components: (i) Statements concerning the economic resources, debts, and equity interests of the company at a specific time (statement of financial position); (ii) Statements concerning changes in the economic resources, debts, and equity interests of the company during a specific period (statement of activities) (2) Components of financial statements: (i) Assets; (ii) Liabilities; (iii) Equity; (iv) Revenue; (v) Expense; (vi) Profit; and (vii) Loss
4. Recognition and measurement of financial statements	(1) Recognition: A process for presenting items in financial statements of the company Note: Recognition criteria: (a) Basis of measurement; and (b) Probability of acquisition or renunciation of economic benefits (2) Measurement: a process for determining the money amount of items recognised in financial statements Note: Basis of measurement: (a) Principal basis (historical value); and (b) Other bases (replacement cost, feasibility amount, current value, and market value)

FRF = Financial Reporting Framework; SMEs = small- and medium-sized entities.
Source: American Institute of CPAs, Financial Reporting Framework for SMEs

Managers and creditors are considered to be the major users of financial statements and emphasis is put on its usefulness for decision-making by managers and usefulness for evaluation of the fiduciary duties by creditors. Such spirits may be different from the conceptual framework of FASB, which focuses on usefulness for investment decision-making by investors, and is more similar to the spirit of the Japanese Accounting Standards for Small- and Medium-Sized Enterprises. This is where FRF for SMEs is special as an accounting standard for SMEs.

The ‘qualitative characteristics of financial information’ resembles the conceptual framework of FASB, and includes understandability, suitability for purposes, reliability, and comparability. On the other hand, it is characteristic that conservatism is included as a component of reliability.

In ‘components of financial statements’, the components are divided into two categories: ‘statement of financial position’ and ‘statement of activities’. Comprehensive income is not included as a component of financial statements.

In ‘recognition and measurement of financial statements’, the measurement basis is historical cost (acquisition cost) in principle, and actual cost other than market value is treated as an exception. Therefore, it is characteristic that write-downs, which require time evaluation, are seldom required.

(ii) Characteristics in terms of approach

An important point to note is that the bottom-up approach is adopted for FRF for SMEs as well. This is not an approach where, just as IFRS for SMEs and the US GAAP, only parts that can be adopted by SMEs are extracted from the existing accounting standard for large corporations or the existing accounting standard is simplified to apply to SMEs. In this approach, a new accounting standard is established, taking into consideration what kind of accounting standard is necessary and desirable for SMEs.

(iii) Other characteristics

According to AICPA, major users of financial statements prepared under FRF for SMEs are owners of SMEs, professionals such as lawyers and doctors, banks and other fund suppliers, insurance companies, guarantors, and individual investors. This is also one of the characteristics of an accounting standard for SMEs.

Another characteristic is the compatibility of the accounting standard with tax systems. The most remarkable example is the permitted application of LIFO in connection with methods of inventory valuation. According to the Frequently Asked Questions on FRF for SMEs prepared by AICPA, as LIFO is adopted in tax affairs in the US, standards based on tax laws are integrated into FRF for SMEs so that the difference between the standards based on tax laws and FRF for SMEs can be made smaller in accounting practices of SMEs. Though selection of FRF for SMEs by managers is optional, as explained earlier, LIFO is permitted so as to promote adoption of FRF for SMEs, taking into consideration accounting practices of SMEs[23].

In addition to the above, it is also characteristic that write-off is not required. While the current price is generally used to measure the recoverable amount of an asset, sometimes, the current price cannot be estimated or the reliability of the estimated current price is not assured due to lack of exchange markets. In such cases, the reliability of write-off accounting, which is based on the current price, may be also decreased. In addition, it is not permitted to evaluate derivatives at the current price, so tasks which may put too much burden on managers of SMEs, such as prediction of future events and estimate calculation, may have been reduced.

4) Efforts to promote the spread of FRF for SMEs, and the status of spread

To what extent then is FRF for SMEs actually accepted by SMEs in the US? We will explain efforts to promote the spread of FRF for SMEs and the status of the spread.

(i) Efforts to promote the spread

Since the release of FRF for SMEs in 2013, AICPA has been providing various information including models to facilitate actual usage[24]. A model of consolidated financial statement, filled in with actual numbers assuming a fictitious company, has been published. A comparison table with other accounting standards and introduction movies with animation have been uploaded.

Various reference materials have been supplied with the name 'Toolkit'. It is very unique in that different reference materials are provided to users with different positions or attributes. There are reference materials for CPAs of small companies, for CPAs of SMEs, for CPAs of large corporations, and for users of financial statements (assumed to be financial institutions), thereby promoting utilisation.

(ii) Status of spread

Is this new accounting standard for SMEs really spread?

We will introduce the results of the questionnaire conducted by Thomson Reuters in

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[23] Gaibun Shu, America, Real Situation and Issues in Western Countries, edited by Teruyuki Kawasaki, 2015.

[24] AICPA website: Financial Reporting Framework. http://www.aicpa.org/INTERESTAREAS/FRC/ACCOUNTINGFINANCIALREPORTING/PCFR/Pages/Financial-Reporting-Framework.aspx

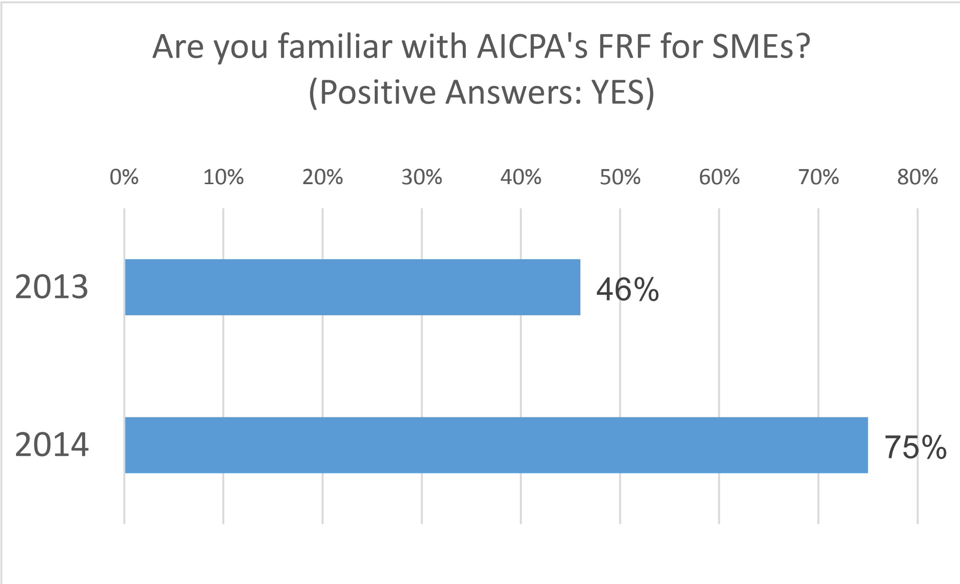
connection with the status of spread of FRF for SMEs in 2013 and 2014.[25]

This questionnaire was conducted as part of The Tax and Accounting Business of Thomson Reuters by Thomson Reuters, and was answered by accounting experts such as CPAs. There were 213 respondents in 2013 and 318 respondents in 2014.

(a) Recognition of FRF for SMEs

Responses to the question 'Are you familiar with FRF for SMEs?' by accounting experts are as follows: About half (46 percent) of the respondents gave a positive answer in 2013. The percentage of respondents answering positively increased to 75 percent in 2014. Recognition seems to have considerably improved.

Figure 7: Percentage of professionals familiar with FRF for SMEs



AICPA = American Institute of Certified Public Accountants; FRF = Financial Reporting Framework; SMEs = small- and medium-sized entities.

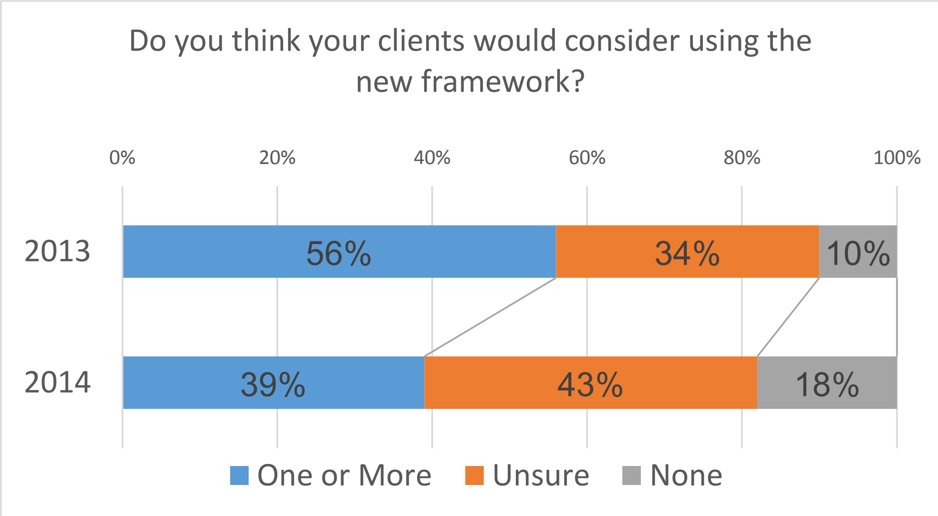
(b) Clients' willingness to adopt FRF for SMEs

However, in response to the question 'Do you think your clients would consider using FRF for SMEs?', the percentage of respondents who answered 'I think one or more clients would' decreased from 56 percent in 2013 to 39 percent in 2014. On the other hand, the percentage of respondents answering 'Unsure' increased from 34 percent in 2013 to 43 percent in 2014,

[25] Thomson Reuters, The AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities - An Update, July 2014.

which means there is uncertainty as to actual introduction of FRF for SMEs on practical levels.

Figure 8: Interest in the introduction of FRF for SMEs



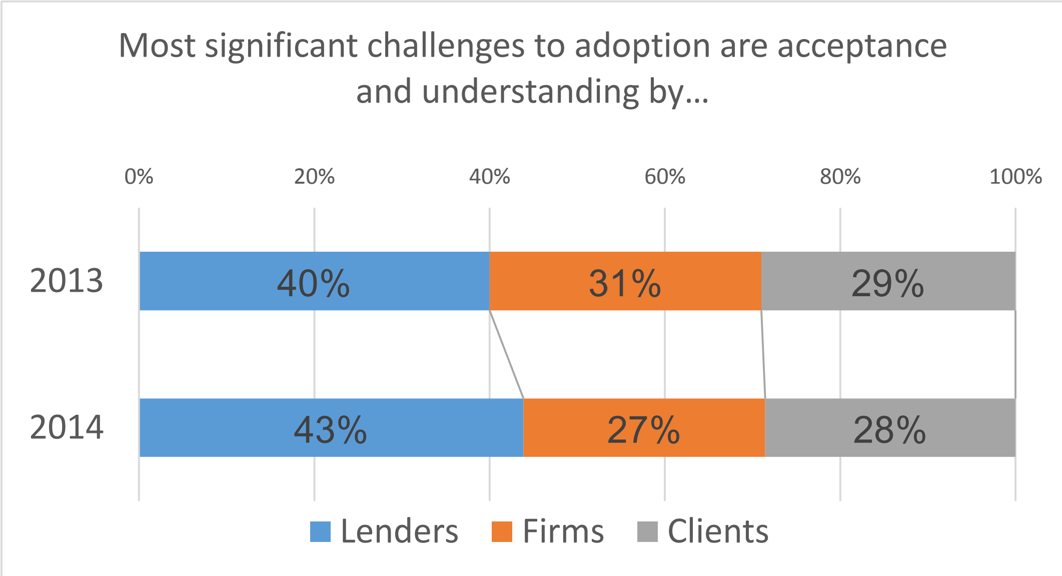
FRF = Financial Reporting Framework; SMEs = small- and medium-sized entities.

(c) Key players concerning introduction of FRF for SMEs

Though enthusiasm for actual introduction has decreased a little from 2013, 39 percent of the accounting experts still answered that their clients are willing to introduce FRF for SMEs. Among the stakeholders then, whose understanding is most important for actual introduction?

In response to this question, almost the same percentage of accounting experts answered that the most important stakeholder was the lenders, both in 2013 and in 2014.

Figure 9: Significant Stakeholder in the introduction of FRF for SMEs



FRF = Financial Reporting Framework; SMEs = small- and medium-sized entities.

The discussion on the introduction of FRF for SMEs below refers to actual cases.

Mr. Rodney E. Rice (CPA) commented that explanation to banks would be a top priority for the introduction of FRF for SMEs. He pointed out that a small or medium company can adopt FRF for SMEs only after the company holds a meeting with its bank to explain the advantages of FRF for SMEs and the bank agrees to modify the agreement executed between the company and the bank to include the provision 'Preparation and submission of financial reports under any accounting standard other than GAAP shall be permitted.'

His comment is suggestive, indicating that the kind of accounting standard that SMEs will establish will depend on the lenders. It is important to obtain the approval of financial institutions when trying to introduce and spread a new accounting standard.

Due to the aforementioned reasons, it can be concluded that FRF for SMEs is spreading slowly, gradually obtaining the understanding of SMEs and accounting experts, and further obtaining the understanding of lenders who are the key stakeholders in the US.

(3) Differences between FRF for SMEs and IFRS for SMEs

We investigated the actual situation surrounding SME accounting in the ASEAN region and considered what policies should be like in order to achieve desirable conditions in future. As a reference for such consideration, we examined differences between FRF for SMEs and IFRS for SMEs, which are the original accounting standards for SMEs in the US.

Table 39: Differences between FRF for SMEs and IFRS for SMEs

Topic	FRF for SMEs	IFRS for SMES
(1) Comparative Financial Statements	Comparative financial statements are not required.	Requires comparative information in respect of the previous comparable period for all amounts presented in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information when it is relevant to the understanding of the current period's financial statements.
(2) Comprehensive Income	No concept of comprehensive income or items of other comprehensive income.	Provides an accounting policy choice between presenting total comprehensive income in a single statement or in two separate statements. Certain items are classified as other comprehensive income and displayed as such.
(3) Fair Value	Uses the term 'market value', defined as 'the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act'. Market value measurement used only in very limited circumstances, such as business combinations, certain non-monetary transactions, and marketable equity and debt securities held-for-sale.	Use the term 'fair value'. This is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Wider use of fair-value measurements compared to the FRF for SMEs accounting framework.
(4) Inventories	Last in, first out (LIFO) is permitted.	LIFO is not permitted. Inventory is assessed at the end of each reporting

Topic	FRF for SMEs	IFRS for SMES
		period for impairment or for recovery of previously recognised impairment.
(5) Subsidiaries	A subsidiary is defined as an entity in which another entity owns more than 50 percent of the outstanding residual equity interests. Policy choice to either consolidate subsidiaries or account for subsidiaries using the equity method. No concept of special purpose entities (SPEs) or variable interest entities.	A subsidiary is defined as an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. If an entity has created a special purpose entity (SPE) to accomplish a narrow and well-defined objective, the entity shall consolidate the SPE when the substance of the relationship indicates that the SPE is controlled by that entity.
(6) Investments/ Financial Assets and Liabilities	Historical cost approach for investments and financial assets and liabilities. Market value measurement required only for investments being held for sale, with changes in market value included in net income. Investees, over which the investor has significant influence, are accounted for under the equity method.	There are two classifications/ categories for financial instruments: amortised cost and fair value through earnings. Basic financial instruments are measured at amortised cost, except for investments in nonconvertible and non-puttable preference shares and non-puttable ordinary shares that are publicly traded or whose fair value can be measured reliably. All instruments other than basic debt instruments (including instruments with embedded derivatives) are measured at fair value through earnings. Investments in associates (entities in which the investor has the ability to exercise significant influence) are accounted for using one of the following methods: the cost method (if there is

Topic	FRF for SMEs	IFRS for SMES
		no published price quotation); equity method; or fair-value-through-earnings method.
(7) Derivatives	Disclosure approach. Recognition at settlement (cash basis). No hedge accounting.	Derivatives are recognised and measured at fair value through earnings. Hedge accounting is prescribed.
(8)Stock-Based Compensation	Disclosure only.	Compensation expense is recognised. Specific accounting depends on terms and type of instrument.
(9) Leases	The criteria for determining whether a lease is a capital lease to a lessee generally are similar to IFRS for SMEs. Unlike IFRS for SMEs, however, the FRF for SMEs accounting framework provides specific quantitative thresholds for determining certain criteria. Under the FRF for SMEs accounting framework, if land is the sole item of property leased, the lessee accounts for the lease as a capital lease only if the lease transfers ownership of the property at the end of the lease term. From the point of view of a lessor, some additional criteria must be met to classify the lease as a capital lease. Under the FRF for SMEs accounting framework, lessors' capital leases are categorised as direct financing leases or sales-types leases (both similar to the finance lease category in IFRS for SMEs).	See the FRF for SMEs column.
(10) Goodwill	Amortised over the same period as that used for federal income tax purposes or 15 years. No impairment testing.	Goodwill is amortised over its useful life. If an entity cannot reliably estimate its useful life, the life is presumed to be 10 years. Impairment testing is required only when there is an indicator of impairment.
(11) Intangible Assets	All intangible assets are considered to have a finite useful life and are amortised over their estimated useful lives. In accounting for expenditures on internally generated intangible assets during the development phase, management should make an accounting policy choice to either expense such expenditures as incurred or capitalise such expenditures as an intangible asset, provided the criteria are met.	All intangible assets (including goodwill) are finite—lived and are amortised over their useful lives. If an entity cannot reliably estimate the useful life of an intangible asset, the life is presumed to be 10 years. Expenditures on

Topic	FRF for SMEs	IFRS for SMES
		internally developed intangibles, including research and development costs, are expensed as incurred, unless they are part of the cost of another asset that meets the recognition criteria in IFRS for SMEs.
(12) Statement of Cash Flows	Cash inflows from interest and dividends received are classified as cash flows from operating activities. Cash outflows related to interest paid are classified as an operating activity, unless capitalised. Cash outflows related to dividends paid are classified as cash flows used in financing activities. Cash outflows from dividends paid by subsidiaries to non-controlling interests are presented separately as cash flows used in financing activities.	An entity may classify interest paid and interest and dividends received as operating cash flows because they are included in profit or loss. Alternatively, the entity may classify interest paid and interest and dividends received as financing cash flows and investing cash flows, respectively, because they are costs of obtaining financial resources or returns on investments. An entity may classify dividends paid as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, the entity may classify dividends paid as a component of cash flows from operating activities because they are paid out of operating cash flows.
(13) Debt Covenant Violation	Debt covenant violations may be cured after the balance sheet date, eliminating the need to reclassify the debt.	Curing a debt covenant violation after the balance sheet date may not eliminate the need to reclassify the debt.
(14) Investment Property	No specific definition of investment property. Investments in land and buildings are accounted for as property, plant, and equipment.	Separate accounting guidance for investment property. Investment property is property (land or building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or

Topic	FRF for SMEs	IFRS for SMES
		for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes, or sale in the ordinary course of business.
(15) Component Depreciation	No requirement for separate components of an asset (nor is there a prohibition against doing so). Composite depreciation method may be used.	If the major components of an item of property, plant, and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life.
(16) Joint Ventures	A venturer should make an accounting policy choice to account for its interests in joint ventures using one of the following methods: - Equity; or - Proportionate consolidation. Only applicable to unincorporated entities where it is an established industry practice.	Investments in jointly controlled entities may be accounted for using one of the following methods: - Cost (if there is no published price quotation); - Equity; or - Fair-value-through-earnings.
(17) Impairment of Long-Lived Assets	No assessment of impairments for long-lived assets. A depreciated or amortised cost approach is followed. Assets no longer used are written off.	Impairment testing is required only when there is an indicator of impairment.
(18) Contingencies	A contingency is recognised when: - It is probable that a future event will confirm that the value of an asset has diminished or a liability has been incurred at the date of the financial statements; and - The amount of the loss can be reasonably estimable. 'Probable' is defined as likely to occur, a threshold higher than the 'more likely than not' threshold used in IFRS for SMEs.	A contingency is recognised when it is more likely than not that the entity will be required to transfer economic benefits in settlement and the amount of the obligation can be estimated reliably.
(19) Income Taxes	Policy choice to account for income taxes using either the taxes payable method or the deferred income taxes method. No evaluation or accrual of uncertain tax positions.	Income taxes accounted for using a deferred income tax method. Uncertain income tax positions must be evaluated and accrual made if certain conditions are met.
(20) Borrowing	An entity can choose to capitalise interest costs	Borrowing costs are

Topic	FRF for SMEs	IFRS for SMES
Costs	related to an item of property, plant, and equipment that is acquired, constructed, or developed over time. When a financial liability is issued or assumed in an arm's length transaction, an entity should measure it at its exchange amount adjusted by financing fees and transaction costs that are directly attributable to its origination, acquisition, issuance, or assumption. An entity can choose to capitalise interest costs related to inventories that require a substantial period of time to get them ready for their intended use or sale.	interest and other costs that an entity incurs in connection with the borrowing of funds. An entity should recognise all borrowing costs as an expense in net income in the period in which they are incurred.
(21) Long-Lived Assets Held for Sale	A long-lived asset to be sold should be classified as held for sale and presented separately in the entity's statement of financial position. The assets and liabilities of a disposal group classified as held for sale should be presented separately in the asset and liability sections, respectively, of the statement of financial position. A long-lived asset should not be amortised while it is classified as held for sale.	There is no 'held for sale' classification for non-financial assets or groups of assets and liabilities and related measurement provisions.

FRF = Financial Reporting Framework; IFRS = International Financial Reporting Standards; SMEs = small- and medium-sized entities.
Source: AICPA, Comparisons of the FRF for SMES reporting framework to other bases of accounting, AICPA, 2014.

As described above, FRF for SMEs differs with IFRS for SMEs in major issues. This includes differences in the establishment processes (bottom-up approach versus top-down approach). In addition, care seems to have been taken to reduce the burden on SMEs, which have no human resources dedicated to accounting functions, with attention being paid to the purposes managers of SMEs will use accounting for.

(4) Conclusion

No specific accounting standard for SMEs exists in the US. The IFRS for SMEs, FRF for SMEs, and the revised US GAAP for SMEs are being considered.

FRF for SMEs, which has been developed using the bottom-up approach and considers the usability for SMEs and the purposes of accounting, is characteristic in that it defines target companies qualitatively and not quantitatively. It is compatible with tax laws, can be actually adopted by SMEs, and is useful for the management of SMEs.

In particular, SMEs that are not planning to go public or aggressively expand business overseas will find FRF for SMEs instructive because it is useful for continuously and objectively understanding the situation of operations while reporting to a few stakeholders such as financial institutions.

In addition, thanks to the provision of various information and tools by AICPA for the purpose of spreading FRF for SMEs, about 75 percent of accounting experts recognise FRF for SMEs as an accounting standard, and about 40 percent of accounting experts feel that their clients may adopt it, though it has been released only for three days. In order to achieve further popularisation, it is necessary to persuade or invite lenders (such as banks) giving loans to SMEs to recognise the usability of this accounting standard and to admit financial reporting under this accounting standard in the provisions of their agreement with the SMEs.

5. United Kingdom

(1) Recent Movements regarding Accounting for SMEs

Since the UK is a member of the EU, the consolidated statements of listed companies in the country became compulsorily covered by the IFRS (the EU version of IFRS) in January 2005. Individual financial statements were using the conventional UK accounting standards (UK-GAAP) and the IFRS without any common framework. Therefore, the convergence between the UK-GAAP and the IFRS has become an issue to be addressed by the accounting authority.

Then, in 2010, the UK Accounting Standards Board (ASB) presented a draft proposal for reforming their accounting system titled, Policy Proposal: The Future of UK-GAAP, which is characterised by the following four points:

- Companies with public accountability (Tier 1) should be subject to the IFRS (EU-IFRS);
- Companies without public accountability (mainly medium-sized entities) (Tier 2) should be subject to the IFRS for SMEs;
- Small-sized entities (Tier 3) should be subject to the Financial Reporting Standard for Small Entities (FRSSE). The FRSSE is the simplified version of the Financial Reporting Standard (FRS), the UK's accounting standard for publicly owned companies. The FRSSE was issued in 1997 and is the first ever accounting standard specifically designed for small-sized entities in the world.

- It is possible for companies of the second and third tiers to adopt an accounting standard of a higher level.

However, this reform proposal was amended and the full introduction (adoption) of the IFRS for SMEs for Tier 2 companies was postponed. Instead, it was decided that the IFRS for SMEs would be incorporated into the FRS. Then, in 2013, the FRS 102, the Financial Reporting Standard applicable in the UK and the Republic of Ireland which would serve as the new UK-GAAP, was published. This FRS 102 (new UK-GAAP) is based on the IFRS for SMEs, but some revisions have been made, including ensuring conformity with the UK Company Act. As a result, the UK accounting standards became a three-tier structure consisting of the IFRS (EU-IFRS), the FRS 102 (new UK-GAAP), and the FRSSE.

Table 40: Accounting system in the UK

Tier	Entities Covered	Accounting Standard
Tier 1	Listed companies or companies voluntarily adopting the IFRS	IFRS (EU-IFRS)
Tier 2	companies other than those classified as Tiers 1 and 3	FRS 102 (new UK-GAAP)
Tier 3	Small-sized entities	FRSSE

EU = European Union; IFRS = IFRS = International Financial Reporting Standards; GAAP = Generally Accepted Accounting Principles UK = United Kingdom.
Note: For example, any subsidiary of a listed company that is included in the consolidated financial statements of the listed company is subject to the IFRS, but the mitigation of disclosure requirements is applicable (FRS 101).
Source: Teruyuki Kawasaki, Accounting System for Small- and Medium-Sized Entities, Chuo Keizai Sya YEAR?.

(2) Characteristics and Details of FRSSE

FRSSE is the simplified version of FRS, which is applicable to publicly owned companies in the UK. It is the first ever accounting standard for small-sized entities in the world, being issued in 1997. The volume of the contents of the FRSSE is about 10 percent of the FRS, and its coverage is small company (and small group), which is defined in the Company Act as follows:

Table 41: Definitions of small company and small group under the UK Company Act

Small Company (individual)	Small Group
At least two of the following criteria are satisfied within the period of one year: ● Turnover of £6,500,000 ● Balance sheet total of £3,260,000 ● Average number of employees is 50	At least two of the following criteria are satisfied within the period of one year: ● Aggregate turnover of £6,500,000 net (or £7,800,000 gross) ● Aggregate balance sheet total of £3,260,000 net (or £3,900,000 gross) ● Aggregate number of employees is 50

£ = British Pound; UK = United Kingdom.
Source: Financial Reporting Council, 'Financial Reporting Standard for Smaller Entities (effective January 2015)'.

The mitigating measures under the FRSSE are characterised by the following points:

- Significant reduction of the volume of accounting standards. While the FRS consists of 1,600 pages, the FRSSE contains about 100 pages and, without appendices, less than 70 pages);
- Significantly simplified requirements concerning indications and notes;
- Its accounting procedures are almost similar to those of the FRS except for some exceptions; and
- Whether or not to introduce the standard is left to the discretion of individual companies and accountants who are to conduct the audit.

As a specific example, small-sized entities are not required to prepare statements of cash flow, and requirements concerning balance sheets have been simplified so that small-sized entities need not prepare their balance sheets in such detail as required of large-scale companies, if they are to be filed with the Registrar. In addition to these, small-sized entities are exempted from statutory audit.

(3) Differences between the FRS 102 (new UK-GAAP) and the IFRS for SMEs

Though the FRS 102 (new UK-GAAP) has been developed based on the IFRS for SMEs, certain revisions have been introduced, including ensuring consistency with the UK Company Act. For example, in the UK, financial statements prepared in accordance with the provisions of the Company Act are called Companies Act accounts, and they are distinguished from those prepared in accordance with the EU-version IFRS (IAS accounts). Financial statements prepared in accordance with the FRS 102 fall under the category of Companies Act accounts. Therefore, in Section 4, Statement of Financial Position, and in Section 5, Statement of Comprehensive Income and Income Statement of FRS 102, most of the provisions of the IFRS for SMEs have been removed and replaced by those of the Company Act.

In addition, in Section 9, Consolidated and Separate Financial Statements, provisions concerning consolidated financial statements of the IFRS for SMEs are amended in line with the Company Act. Further, Section 19, Business Combinations and Goodwill, requires that the amortisation of goodwill should be made over a period within five years in principle (whereas, the IFRS for SMEs provides for the amortisation period of within 10 years).

(4) Conclusion

The UK accounting standards are of a three-tier structure: the IFRS (EU-IFRS) for listed companies; FRS 102 (new UK-GAAP) mainly for medium-sized entities; and FRSSE for small-sized entities. Among them, FRS 102 (new UK-GAAP) has been designed based on the IFRS for SMEs. However, FRS 102 is not the full introduction (adoption) of the IFRS for SMEs. Certain adjustments in line with the country's actual situation, including the UK Company Act, have been added. It should be noted that the FRSSE is the first ever accounting standard specifically developed for small-sized entities in the world and it is a significantly simplified version of the FRS, which used to serve as the UK-GAAP, comprising 100 pages or so including the appendices.

These characteristics, namely the three-tier structure and partial adoption of the IFRS for SMEs to create accounting standards for SMEs and unlisted companies, can also be found in the Korean system described earlier. In addition, even in those countries where listed companies are compulsorily covered by the IFRS (China, Korea, and the UK), when it comes to SMEs and unlisted companies, the IFRS for SMEs has not been introduced or adopted as it is. Country-specific accounting systems have been designed to suit the actual situations of the respective countries. In considering an accounting system for SMEs, the IFRS for SMEs is a very important accounting standard and serves as a very important reference. However, it is also very important to put into consideration the actual situations facing SMEs in their respective countries. Such conclusions seem to be suggested from the case studies on these countries.